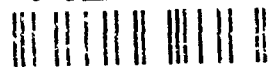


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AN INVESTIGATION INTO FRAUD AND UNETHICAL
CONDUCT IN THE CONSTRUCTION INDUSTRY

Submitted in Fulfillment
of Requirements for
ENCE 799

Jim Gentry
(Instructor: Professor Roy Pilcher)

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ABSTRACT

A project manager, contract administrator, or owner's representative (all terms often used to refer to the owner's representative) is usually involved in several of the many stages of a project. Some of the different stages include: project design, bidding, contract award, contract administration while project is under construction, and claims resolution.

In order for the owner's representative to successfully represent the owner and manage the project, he should be aware of some of the problems and pitfalls that may be encountered and be prepared to effectively deal with them. This paper will look at problems caused by fraudulent and unethical conduct and will concentrate on federal government construction contracts. Signs and indicators of fraud will be discussed as well as methods of preventing fraudulent behavior or dealing with fraud once it is discovered.

CHAPTER 1: INTRODUCTION

Each year billions of dollars are spent on construction in the United States¹, with a substantial portion funded by public money (federal, state, and local taxes).

It seems that whenever large sums of money are at stake, a small percentage of people will devise unethical and/or fraudulent schemes in an attempt to acquire a share of the money. Unethical and fraudulent practices increase the cost of construction with some estimates of increased costs as high as 15 percent.² Some of the most common unethical and fraudulent practices occurring in the construction industry will be discussed in this paper.

Construction contracting has evolved over the years and has its own set of rules and regulations. Some of the rules and regulations are spelled out in the form of a contract. Others are established by federal, state, and local regulations.

The federal acquisition regulation (FAR) is the source of most of the procurement and contracting regulations that govern federal construction contracts and will be referenced frequently throughout this paper. Some trade and professional societies publish codes of ethics which are attempts to set standards of behavior for their members. Ethics can be defined as the discipline dealing with what is good and bad and with moral duty and obligation. It is also the principles of conduct governing an individual or a group. Fraud in government contracts can be defined as willful or conscious wrong doing that adversely affects government interest. Fraud includes but is not limited to:³

- a) Falsification of documents.
- b) Charging personal expenses to government contracts (Cost type of contracts).
- c) Division of government property or funds for unauthorized uses.
- d) False claims.
- e) False allocation of contract costs (Cost type of contracts).
- f) Deceit by suppression of truth.
- g) Bribery.
- h) Theft.
- i) Graft.
- j) Conflict of interest.
- k) Gratuities.
- l) Anti-trust violation.
- m) Intentional delivery of inferior goods/ buy american violation.
- n) Kick Backs.

If a contractor has committed fraud he has certainly acted unethically. But conversely all unethical acts are not considered fraud. For example: A contractor who furnishes his workers old worn out safety equipment is not acting in the best interest of his employees (not fulfilling moral obligation). If an accident were to occur as a result of the safety equipment, it is likely that investigations would be made by various regulatory safety agencies but it is not likely that the contractor has committed fraud. On the other hand if the contractor was required by law to maintain

proper safety equipment and keep detailed records of maintenance performed, and willingly falsified maintenance records he would probably be prosecuted for fraud. In order to understand unethical and fraudulent practices it is helpful to know what each party's rights and responsibilities are to the other. These rights and responsibilities will be discussed throughout this paper along with the ways in which one of the parties may violate them.

Key steps in eliminating unethical and fraudulent practices include: understanding the practices, recognizing the warning signs and indicators of such practices, and knowing how to effectively deal with such practices once they are discovered.

In the case of publicly funded projects, the public has placed their trust in those officials charged with administering the projects and has a right to expect that their money will not be wasted through unethical or fraudulent practices from either the agency administering the contract (owner) or the contractor.

It is the aim of this paper that both public and private owners as well as contractors become more aware of the unethical and fraudulent practices that plague the construction industry. Through this awareness owners and contractors can become better educated and suited to respond to these practices.

1.1 Government Contracting as a Socio-Economic Activity

Most construction projects or programs have as an end goal a quality facility that is built on time, within budget, and serves the need of the owner or user occupying the facility. The contractor is monetarily compensated in return for his ability to

meet these goals. Government contracting (federal and most other forms of government) is a socio-economic program.

In general, the goal of socio-economic programs is to provide social benefit to some select portion of the population by economic means. The population that is to benefit is selected by those officials in charge of making the contracting regulations and laws in this country; or in other words it is a political process. This population that is often selected because it is felt that by helping a specific group the government and hence the people as a whole would benefit. Examples of such socio-economic programs in federal contracting are the minority and small business contracting policies (discussed in chapter 10), the buy american act (discussed in chapter 5), and various labor laws that are specific to federal construction contracts (discussed in chapter 9). The enforcement of these socio-economic programs places and additional administrative burden on the contracting agency* and adds another dimension to construction contracting.

CHAPTER 2: CONTRACT AWARD

2.1 Contracting

Most government construction contracts are awarded using sealed bids on a fixed price basis. Sealed bidding is a method of bidding in which all contractors submit their bids to the contracting agency in a sealed envelope. Fixed price contracts are those in which the contractor performs all of the work described in the contract drawings and specifications for a fixed sum of money. This sum of money would only be increased by a change order for additional work or changed circumstances (see chapter 6).

Two notable exceptions to this type of contract are the set aside contracts (see chapter 10), and cost plus incentive fee contracts.

2.2 Sealed Bidding

Fixed price sealed bidding contracts are most appropriate when the requirements are well known and can be described in the technical specifications and drawings. It is also required that fixed price contracts be used when using the sealed bidding method.⁴ Fixed price sealed bidding consists of the following actions:

- 1) Contract documents are prepared.
- 2) The contract is advertised for bidding.
- 3) Bids are received (lump sum for work described).
- 4) Bids are opened.
- 5) Bids are evaluated.
- 6) Contract is awarded.

An invitation for bids package (IFB) is prepared for each contract. The IFB contains all of the contract documents including the drawings, technical specifications, and instructions and forms for submitting bids. Contractors who have placed their names on a prospective bidders list in the contracting office are sent notices about the project scope and time and location that the IFB package is available. Contractors can receive IFB packages by contacting the contracting office responsible for administering the contract. The solicitation for bids is also required to be advertised in the Commerce Business Daily (CBD) for any contract over \$25,000.⁵ A minimum of 30 days is required between the time that a solicitation for bids appears in the CBD and the opening of bids.⁶ This time is to permit all bidders that are interested the necessary time to bid on the project. Bids are opened at the time and location stated in the IFB package.⁷ All bids that are not of a classified nature (vast majority of government construction contracts) are opened publicly and read aloud to the persons present, and then recorded. The bids are open to public inspection after the bid opening. The award must be made to the responsible* bidder who submitted the lowest responsive* bid, unless there is a compelling reason to cancel the invitation. Reasons to cancel the invitation include:⁸

- 1) Inadequate or ambiguous specifications were cited in the IFB.
- 2) Specification has been revised.
- 3) The services being contracted for are no longer required.
- 4) All otherwise acceptable bids received are at unreasonable prices, or only one bid is received and the contracting officer

cannot determine the reasonableness of the bid price, or no responsive bid has been received from a responsible bidder.

5) The bids were not independently arrived at in open competition, were collusive, or were submitted in bad faith.

6) For other reasons, cancellation is clearly in the public's interest (this reason usually requires approval from the head of the contracting agency).

All reasons for canceling an IFB must be properly documented.

Most owners use some form of sealed bidding fixed price contracts as it is the easiest type of contracting. The sealed bidding process is open to public scrutiny in federal construction contracts; this may not be the case for private owners using sealed bidding. Opportunities for tampering in the bidding process do exist.

2.3 Safeguards Against Tampering

In government construction contracts, all bids that are received before the time bids are due are placed in a locked bid box or safe.⁹ Typically only limited personnel have access to the bid box. Any bids received by the government after the time set for bid opening are considered late bids. Late bids are not acceptable unless:¹⁰

- 1) The bid is received before the contract is awarded and
 - a) It was sent to the contracting office by registered or certified mail no later than five calendar days before the bid opening date or,
 - b) It was sent by mail or telegram and it is determined that

the late receipt was due solely to mishandling by the government or,

- c) It was sent to the contracting office by U. S. Postal service express mail next day service not later than two working days prior to the date specified for receipt of bids.¹⁰

The above rules eliminate the potential for anyone standing in the vicinity of the bid opening area that may overhear the results to rush in with a bid that has just been prepared. In arriving at the low responsive responsible bidder some bids may be rejected by the government. The following are reasons for rejecting bids:

- 1) Failing to conform to the essential requirements of the IFB.
- 2) When a bidder imposes conditions that would modify requirements of the invitation or limit the bidder's liability to the government.

All bidders must bid on performing the work as described in the IFB. To allow any exceptions would be unfair to other bidders.¹¹

After bids are opened, the contracting officer* examines the bids for mistakes. If the contracting officer suspects that the low bidder has made a mistake, the contracting officer will contact the low bidder and ask him to verify the bid calling attention to the suspected mistake.¹²

Apparent clerical mistakes on the face of the bid may be corrected. Some examples include obvious misplacement of a decimal point, and obvious incorrect discounts (1 percent discount for

payment in 10 days, 2 percent discount for payment in 20 days).¹³ The authority to correct bid mistakes is limited to bids, that as submitted, are responsive to the invitation and may not be used to permit correction of bids to make them responsive.

Bid mistakes may be corrected if the bidder shows clear and convincing evidence of the mistake and the actual intended bid. This correction may not displace the already established low bidder unless the existence of the mistake and the actually intended bid are ascertainable from the invitation and the bid itself.

A low bidder that claims a mistake may be permitted to withdraw his bid if the evidence is clear and convincing both as to the existence of a mistake and as to the actually intended bid, and the bid as corrected would no longer be the low bid. If the corrected bid would still remain the low bid, the contracting officer may correct the bid and not permit its withdrawal. The author has not seen the latter occur. There seems to be a desire not to force a contract upon a contractor who from the very beginning does not want to perform the work, although, the contractor may lose his posted bid bond if he refuses to perform the contract. Allowing a contractor to simply withdraw his bid for unsubstantiated reasons may encourage bid rigging as discussed in chapter 3. A contractor who is the low bidder by a large margin could be approached by the next lowest bidder and be offered a kickback to withdraw his bid.

Some contractors after seeing the results of the bid opening may grow concerned that as the low bidder they are far below other

bidders and recalculate their estimate looking for errors. Other contractors may see that their bid is far lower than the other bids and that a large sum of money has been "left on the table." Under these circumstances, some contractors are apt to claim they made a bid mistake and try to reclaim some of the money. It is here where the contracting officer must be careful to ascertain that the contractor has presented "clear and convincing evidence" that a mistake has occurred. It is not fair to the other bidders that this contractor has a second chance at bidding but they are not allowed to correct their bids downwards for a second chance. The contractor is somewhat being rewarded for sloppiness in preparing his bid.

In a recent contract for housing renovations at the Naval Academy, bids were received from several contractors. The low bid was approximately \$ 2.7 million and was more than \$ 1 million below the next low bidder. The low bidder claimed that he made an error and did not multiply his carpentry costs of approximately \$ 3000 per housing unit by the total number of units but only added it once. The low bidder submitted his bid estimate sheets filled out in pencil to the contracting officer as evidence that a mistake was made. The contracting agency determined that the evidence was sufficient to permit the correction and awarded the contract. The second low bidder filed a protest about the decision and the protest was sent to the General Accounting Office (GAO) to decide. GAO decided to let the award stand. Allowing correction of bid mistakes forgives contractors who are sloppy in preparing estimates

and may encourage contractors to fabricate errors after learning that "money has been left on the table." The government adjusted the contractor's bid price upwards around \$300,000 but this amount was still over \$ 700,000 below the next bidder. Careful consideration must be given to the decision to allow a correction to be made. The fact that the government is saving over \$ 700,000 should not enter the decision as whether to allow the low bidder to correct his bid.

The contracting officer has the obligation to notify the low bidder if the contracting officer suspects a mistake in the bid and ask the bidder to verify the bid as being correct. A bid that is far below the other bids or the government estimate is suspect for containing an error.¹⁴

If after a contract is awarded, the contractor claims a mistake, the mistake may be corrected by contract amendment, if correcting the mistake would be favorable to the government (ie lowering the price). However, it is unclear why any contractor who is the low bidder and has won by fair competition would do this. The contracting officer may rescind the contract, delete items involved in the mistake, or increase the price of the contract provided the price does not exceed that of the next lowest acceptable bidder. The above corrections can only be made if the mistake is a mutual mistake*, or the mistake was so obvious that the contracting officer should have noticed it.

After the contract is awarded, all unsuccessful bidders are notified that their bids were not accepted.¹⁵ Public announcement

in the CBD is made of all awards over \$ 25,000.¹⁶

2.4 Cost Plus Award Fee Contracts

The cost plus award fee contract is a type of cost reimbursement contract in which the contractor is paid his allowable incurred costs (see chapter 6) up to a certain pre-established ceiling. This type of contract establishes an estimate of the total cost. The contract provides a fee that consists of two parts:

- 1) A base fee (typically around 3 percent of the initial project estimate) and,
- 2) An award amount that is based upon the contractor's performance.

The contractor's performance is evaluated periodically and part of the award fee may be paid to the contractor at each evaluation. Criteria for evaluating performance of the contractor are set forth in the contract and may include his ability to control costs as related to the initial estimate. Periodic evaluations will give the contractor incentive to maintain superior performance or improve performance in anticipation of earning the award fee.

2.4a Use of Cost Plus Award Fee Contracts

This type of contract is used when the scope of work is not adequately defined to permit costs to be estimated with sufficient accuracy to use a fixed price contract. It would be unrealistic to expect a contractor to assume the risk of performing an unknown task at a fixed price. An example of the use of this type of

contract would be the emergency repairs of a facility after a hurricane.

This type of contract can only be used when:¹⁷

- 1) The contractor's accounting system is adequate for determining costs applicable to the contract.
- 2) Government surveillance during performance will ensure that efficient methods and effective cost controls are used.
- 3) It is impractical to obtain the desired service without the use of this kind of contract.

This type of contract is not awarded by using sealed bids since adequate technical specifications often do not exist.

2.4b Award of Cost Plus Award Fee Contracts

Any contract awarded by a method other than sealed bidding is referred to as contracting by negotiation. Negotiation may or may not involve competition. Competition is required in all contracts with the following limited exceptions:¹⁸

- 1) Only one responsible source and no other supplies or services will satisfy agency requirements (not likely to be the case for construction contracts).
- 2) Unusual and compelling urgency (lack of proper planning is not an excuse for foregoing competition).
- 3) Authorized or required by statute (8a program falls into this category, see chapter 10).
- 4) National security, limited competition is authorized if the disclosure of the agency's needs would compromise the national security.

5) Public interest, the authority to use this justification is limited to agency heads (Secretary of the Army, Secretary of the Navy, Secretary of Transportation, etc.).

All reasons for limiting competition must be documented.

Since detailed specifications do not exist, the government solicitation will list the basic requirement of the contract and the evaluation criteria used in selecting a contractor. For example, the basic requirement may be the clean up of debris after a hurricane and repairs to roofs of a certain number of buildings. The requirement would not state the type of roofing or methods to be used.

The process of choosing a contractor is called source selection. Interested contractors would submit a plan of the work and detail the methods they planned to use to satisfy the government's requirements along with the estimated costs as their bid. A board of government representatives would be established to evaluate the contractors proposal. Factors for evaluating a proposal would include items such as: price, technical excellence, management capability, personnel qualifications, previous experience, past performance and schedule compliance. The source that offers the greatest value to the government in terms of performance and the other factors stated in the government's request for proposal will be chosen. There is no requirement to choose the lowest bidder since advance cost estimates may not indicate final actual costs. If the lowest bidder were chosen this would encourage contractors to submit low initial cost estimates

and present the likelihood for cost overruns. Each project should have a specific set of criteria that is made known to the contractor in the solicitation that will be used to evaluate the bids.

This type of contract, while it reimburses a contractor for his allowable costs, is not a "cost plus" contract. A cost plus contract is a type of contract where the contractor is reimbursed for his costs plus a certain percent is added to all costs as profit. This type of contract provides an incentive for the contractor to run up his costs since profits are tied to costs. The cost plus award fee contract provides the contractor an incentive to control costs since the award fee is tied to periodic evaluations which include cost as a factor. Increasing costs above the agreed upon estimate will actually lower the award fee unless the original estimate is allowed to be adjusted upwards. The greatest potential for fraud during this type of contract is the fabrication of charges to increase the contract costs. This can be greatly reduced by thoroughly evaluating the contractor's method of accounting for and controlling costs and by periodic government review.

Negotiation differs from sealed bidding in that discussions may take place with offerors. The discussions are controlled by the contracting officer and may be used to resolve uncertainties concerning technical proposals. In the hurricane example, if one contractor proposed using a rubber membrane roofing, and another contractor was going to use a built up roof, the government could

decide to ask all contractors to revise their initial estimates to reflect the rubber roofing. During these discussions that the contracting officer holds with each individual contractor, nothing that any one contractor says is revealed to another contractor. Auction techniques in which the government tells the contractor he needs to reduce his price by a certain amount to be eligible are not permitted. However, the contracting officer may tell the contractor his estimate is too high for any further consideration. After all discussions have been held, all contractors are given a chance to revise their bids and submit a best and final offer.

2.5 Contractor Receiving of Subcontractor Bids

Prime contractors will solicit subcontractor bids to use as a basis for forming their bids. Once a sub submits a bid to a prime, the bid becomes a firm offer and binds the sub. This puts a price ceiling on the work that the contractor will subcontract. Some contractors engage in "bid shopping" after they receive the contract. In bid shopping the prime contractor will try to increase its profits by finding another subcontractor who will perform the work cheaper than the sub that is committed. The prime contractor is not obligated to use the subcontractor that is the low bidder at the time the contractor submits his bid. Prime contractors will often use confidential information from one subcontractor's bid to try to lower another subcontractor's bid. This practice hurts the subcontracting industry by shaving company profits and may lead to poor workmanship or inflated bids by

subcontractors. Subcontractors will often try to make up profit by looking for change orders.

2.6 Case Study

Public contract administrators have an enormous number of rules and regulations to follow. It can be very tempting to bend some of these rules for the benefit of the contracting agency. The city of Atlanta awarded a \$14 million airport parking garage to a contractor that submitted its low bid three minutes late. The Georgia court of appeals ruled that the city has to pay the next low bidder more than \$1 million in lost profits, legal fees and interest. The late bid was only low by \$10,500. The next low bidder protested to the city the award of the contract. The letter of protest was referred to the city's legal department and was never answered. Local ordinances required that the protests be answered within 10 days and inform the party of its right to an administrative review. The mayor felt that being three minutes late was not significant. This was an expensive lesson for the city of Atlanta.¹⁹

CHAPTER 3: BID RIGGING

3.1 Bid Rigging

The majority of construction contracts are awarded by sealed bidding with the award going to the responsive responsible bidder that submits the lowest price (for more information about bidding methodology see chapter 2). This method of bidding provides for competition among the contractors and ensures the lowest price for the owner and is best suited for projects that have well defined plans and specifications so that all bidders are bidding on the same thing. Sealed competitive bidding provides the contractor with a strong incentive to control his costs during the project. The incentive to control costs can be so strong that the contractor will often try to cut corners if he is losing money or behind schedule (refer to chapter 5 for more information on cost cutting and sloppy work).

Bid rigging is a practice in which some or all of the contractors that are bidding on a project conspire to fix the outcome of the bidding procedure. This illegal practice limits competition. Schemes that allocate contracts and limit competition can take many forms and are only limited by the imagination of the involved parties. Common schemes include bid suppression or limiting, complementary bidding, bid rotation and market division.

Bid rigging is a violation of the Sherman Antitrust Act (15 USC 1). The Antitrust division of the Department of Justice has primary prosecutive jurisdiction on all federal antitrust violations.²⁰ The basis of the federal procurement system with few

exceptions (see chapters 2 and 10), is that contracts are awarded on the basis of free and open competition. This policy was first set by statute in 1890. Title 10 U.S. Code section 2340(a) sets forth a specific requirement that purchases and contracts for property and services be made by formal advertising* and shall be awarded on a competitive basis to the lowest responsible bidder.

3.2 Bid Rigging Schemes ²¹

Bid suppression or limiting - In this type of scheme one or more competitors agree with at least one other competitor to refrain from bidding or agrees to withdraw a previously submitted bid so that another competitor's bid will be accepted.

Complementary bidding - This scheme occurs when competitors submit token bids that are too high to be accepted. Such bids are not intended to secure the owner's acceptance but are merely designed to give the appearance of genuine bidding.

Bid rotation - In bid rotation, all contractors participating in the scheme submit bids, but by agreement take turns being the low bidder.

Market division - Market division schemes are agreements to refrain from competing in a designated portion of a market. A market may be defined as a customer or geographic area. The results of such a division is that competing firms will not bid or will submit only complementary bids when a solicitation for bids is made by a customer or in an area not assigned to them.

3.3 Indicators of Bid Rigging

Bid rigging by its very nature is a secretive activity and

schemes to reduce competition are not readily visible. The following are some indicators of possible anticompetitive activities that were compiled by Department of Defense's Inspector General.²² The following indicators by themselves will not prove that illegal anticompetitive activity is occurring but are sufficient to warrant further investigation by the proper authorities:

- 1) Bidders who are qualified and capable of performing work do not submit bids.
- 2) Certain contractors always bid against each other or conversely do not bid against one another.
- 3) The successful bidder repeatedly subcontracts work to companies that submitted higher bids or to companies that picked up bid packages and could have bid but did not. (Government contracts require that all bidders certify that if they are not the successful bidder they will not perform work as a subcontractor on the contract).
- 4) Different groups of contractors appear to specialize in federal, state, or local jobs exclusively.
- 5) There is an apparent pattern of low bids regularly recurring. A certain contractor may always be the low bidder in a certain geographic area or in a fixed rotation with other bidders.
- 6) Failure of original bidders to rebid, or an identical ranking of the same bidders upon rebidding, when original bids were rejected as being too far over the owner's estimate.
- 7) A certain company appears to be bidding substantially higher

on some bids than other bids of same type work with no logical cost difference to account for the increase.

8) Joint venture bids where either contractor could have bid individually as a prime.

9) Any incidents suggesting direct collusion among competitors, such as the appearance of identical calculation or spelling errors in two or more competitive bids, or the submission by one firm of bids for other firms.

10) Competitors regularly socialize or appear to hold meetings, or otherwise get together in the vicinity of procurement offices shortly before bid filing deadlines.

11) Assertions by employees, former employees, or competitors that an agreement to fix bids and prices or otherwise restrain trade exists.

12) Bid prices appear to drop whenever a new or infrequent bidder submits a bid.

Many of the above mentioned indicators are subtle and verifying that one of the indicators exists could take a lot of time and effort and involve the piecing together of bid results of a large number of contracts for several geographic areas and time periods.

3.4 Is Bid Rigging a Serious Problem ?

Several arguments have been given in defense of bid rigging. One attorney argued that "it sets an upper limit on the price."²³ An industry spokesman claimed that bid rigging does not inflate prices because so many bids, even rigged bids have been less than

the state engineer's estimate.²⁴

These arguments do not make sense. A higher owner's estimate simply reflects the estimator's unfamiliarity or uncertainty in regard to the true market price. Free and open competition will set the true price in a market economy provided no anticompetitive behavior is taking place.

3.5 Penalties for Bid Rigging

Bid rigging is a violation of the Sherman Antitrust Act. Violation of the act exposes executives of the violating companies to imprisonment of up to three years and their companies to fines of up to one million dollars. Most jail sentences handed out for bid rigging are less than one year and often amount only to probation.²⁵ The corporations are subject to large civil fines with several judges handing out the one million dollar maximum fines.

Sometimes the firms that are convicted of bid rigging are debarred* from bidding on any publicly funded contracts. While at first this might seem fair, it has tremendous impact upon the entire company and often the local market. Debarring a contractor whose primary source of business is publicly funded contracts may force the company to lay off a large portion of its work force and economically hurt many workers. Debarment may even drive the price of similar type work higher because of reduced competition in the industry.

A more appropriate penalty would be the sentencing of key bid rigging participants to jail terms of several years and require restitution for inflated bids. The almost non-existent jail terms

are not harsh enough to deter bid rigging activities. The fines are absorbed by the company and are often not significant deterrents, but no one wants to go to jail. There is a good deal of plea bargaining in bid rigging trials. Often several participants will be given immunity from prosecution to testify against other participants.

3.6 Case Histories

Between 1979 and 1983 grand juries in 16 southern and midwestern states brought charges against contractors for bid rigging. As a result, fines of 44 million dollars and jail sentences exceeding 44 years were handed out.²⁶ A GAO report submitted to Congress in May of 1983 characterized bid rigging as "a blatant corruption" of competitive bidding.

Four of the country's top five electrical contractor's were being investigated by grand juries for bid rigging in 1983.²⁷ Fischbach and Moore, the nation's number one electrical contractor at the time, was being investigated by fourteen grand juries. In April of 1984, Fischbach and Moore was fined one million dollars. Watson-Flagg a wholly owned Fischbach and Moore subsidiary received a one half million dollar fine and its chairman was fined 35 thousand dollars and sentenced to one year probation for rigged bids on a General Motors plant in Indianapolis.

On Long Island, five construction companies have dominated major public works projects for more than a decade. In 1984 Newsday undertook a study of contracts awarded over the past 11 years and made some fascinating discoveries. Five companies

received 86 percent of all the money paid on all sewer and highway contracts of over one million dollars. Three of the firms were within 1.5 percentage points in their share of the supposedly competitive contracts. Over the 11 year period, \$919.1 million of more than \$1 billion in state highway and county sewer contracts were awarded to the five companies.²⁸

An industry source said that he had attended a series of meetings among the five contracting firms at which they regularly rigged their bids so that each firm would get a share of the available contracts. Labor unions were also involved in the bid rigging scheme. Their role was to discourage outside bidders by threatening them with labor trouble and to transmit bid figures between various members of the contracting ring. The successful contractor paid the labor leaders one percent of the bid price, according to the source. The five firms are the largest heavy-construction companies on Long Island and could be expected to win a share of local contracts but it was the absence of outside bidders on the contracts that triggered the suspicion of federal and local law enforcement agencies.

3.7 Prevention

Highway construction lends itself to bid rigging has been prevalent in many of these construction projects. Many of the job locations are remote and only a few bidders are able to economically mobilize for the projects. Highway construction requires a large capital investment and many pieces of specialized equipment which only a small number of contractors in some regions

possess.

State departments of transportation are beginning to take preventive actions against bid rigging. Highway officials in Florida, Virginia, New York, and other states are taking proactive steps by increasing their analysis of how busy contractors are in various parts of the state and sizing contracts to maximize competition. The departments of transportation are keeping better abreast of market conditions and material prices.²⁹

CHAPTER 4: INTEGRITY OF CONTRACTING PARTIES

4.1 Conflicts of Interest

In federal government contracting, the government employee has a duty to perform his job in a way that best represents the interest of the government. A conflict of interest occurs when the employee bases his actions based upon the benefit he will receive versus the government.

4.1a Officials Not to Benefit

The officials not to benefit clause is included in all federal contracts, and prohibits any member of or delegate to Congress to be a participating party to the contract or to receive any benefit arising from the contract.³⁰ Contracting officers are forbidden from awarding a contract to a government employee or to a business concern or other organization owned or substantially owned or controlled by one or more government employees.³¹ This policy was enacted to avoid conflicts between the employees interests and their government duties. It also avoids the appearance of preferential treatment by the government of its employees.

4.2 Kickbacks and Bribery

Kickbacks, as defined in federal contracting, means "any money, fee, commission, credit, gift, gratuity, thing of value, or compensation of any kind which is provided directly or indirectly to any prime contractor employee, subcontractor, or subcontractor employee, for the purpose of improperly obtaining or rewarding favorable treatment in connection with a prime contract or in connection with a subcontract relating to a prime contract".³²

The Anti-Kickback Act of 1986 (41 USC 51-58) prohibits any person from:³³

- 1) Providing, attempting to provide, or offering to provide any kickback.
- 2) Soliciting, accepting, or attempting to accept any kickbacks.
- 3) Including, directly or indirectly, the amount of any kickback in the contract price charged by a subcontractor or in the contract price charged by a prime contractor to the United States.

This act also provides for criminal penalties for any person who knowingly and willfully engages in kickbacks. Should the contracting officer discover that kickbacks have been made, the act provides that the contracting officer can offset the amount of the kickback with monies owed by the United States to the prime contractor.³⁴ This act also requires a prime contractor or subcontractor to report in writing to the investigator general of the contracting agency, the head of the contracting agency or Department of Justice if the agency does not have an investigator general any possible violation of the act when the prime contractor or subcontractor has reasonable grounds to believe such violation may have occurred.

The General Accounting Office and the investigator general of the contracting agency can review the contractor's books and records to ascertain whether there has been a violation of the act. One such example of a kickback scheme is a contractor paying a subcontractor to submit a high quote that will be used as the basis

of negotiations for a change order. Participation in kickbacks in federal contracting is a criminal offense. It can be seen from the above example that kickbacks increase the cost of a contract.

4.3 Bribery

A bribe is the giving of money or a favor or promise of money or a favor to a person in a position of trust to influence his judgement or conduct.³⁵ Kickbacks are usually associated with a contractor paying a subcontractor to do something illegal or visa versa. A bribe is usually associated with the prime contractor or subcontractor giving something of value to the contract administrator in return for favorable treatment from the contract administrator. An example would be the payment of money from a prime contractor to an inspector in return for the inspector overlooking certain tests which did not meet the requirements of the specification.

4.4 Gratuities

Gratuities* are different from bribery in that there is usually no request for a specific action in exchange for what is being given. Gratuities are given to enhance a more favorable relationship between the contractor and owner.³⁶ Under federal contracts, a contractor may be terminated if it is determined that the contractor offered or gave a gratuity to an officer, official, or employee of the government and intended, by the gratuity to obtain a contract or favorable treatment under a contract.³⁷ The offer or acceptance of a gratuity is a felony. The contracting official should report any attempts by the contractor to offer a

bribe or gratuity. Failure to report an attempted bribe or gratuity could latter turn the tables on the contracting official by the contractor reporting that the contracting official was soliciting a bribe or gratuity.

4.5 Standards of Conduct

Executive order 11222 of may 8, 1965 and 5 CFR 735 required that contracting agencies prescribe standards of conduct.³⁸ The standards of conduct contain:

- 1) Disciplinary measures for persons violating the standards of conduct, and,
- 2) requirements for employee financial disclosure and restrictions on private employment after leaving government service.

The standards of conduct governing defense department personnel are presented in appendix B.

4.6 National Scandal³⁹

In 1973 Spiro Agnew resigned his office as Vice President of the United States while under investigation for accepting bribes. The story begins in the early 1960's when Spiro Agnew was the Baltimore county executive. The county executive is in charge of the various county government departments including public works. While Spiro Agnew was the county executive he accepted bribes from several architect/engineering (A/E) firms in exchange for selecting the firms for certain design projects. Selection of A/E firms was done on a noncompetitive basis. The firm that was best qualified to perform the design work based upon previous design

experience conveyed to the A/E selection committee in the form of resumes and interviews was selected as the A/E firm to perform design work for the county. The selection committee was composed of engineers in the public works committee who worked under the county executive. The selection committees decision could be overridden at the county executive level.

One A/E firm paid bribes to Agnew through an intermediary. The firm would inform the intermediary which design jobs they wanted and the intermediary would carry the message back to Agnew. Agnew would see to it that the firm was selected for the design contract. A certain percentage ranging from two to five percent of the value of the design contract was kicked back to Agnew when payments from the county were received. The intermediary accepted the payments from the design firm and carried them to Agnew.

In 1966 Spiro Agnew became the governor of the state of Maryland. He appointed Jerome Wolfe as the state secretary of highways. Under Wolfe bribes continued to flow to Agnew for design firms seeking state design contracts.

While governor Agnew approved the construction of a second Bay Bridge parallel to the first bridge starting at the eastern shore of Anne Arundel County and spanning the Chesapeake Bay. It just so happened that Agnew was part owner of a 107 acre tract of land that was needed to build the bridge.

In 1968 Spiro Agnew was chosen to be Richard Nixon's Vice Presidential running mate. One A/E contractor even traveled to the white house offices to finish making a payment owed to Agnew for

work received while Agnew was governor of Maryland.

4.7 Closing Thoughts

There are many rules, regulations, and laws which govern federal construction contracting. It is important that these rules and the standards of conduct be followed. If continued violations of the contracting rules occur, the public will begin to lose confidence in the contracting system. Members of the contracting community that know of illegal activities and remain silent are further contributing to the problem. In these types of situations the public usually becomes outraged and demands more regulation and a better accounting for public money. Increased regulation leads to more rules and further contributes to making federal construction contracting a bureaucratic pursuit and increases costs. The bottom line is that officials that abuse their authority lead to a weakening of the federal contracting system and increase costs for the construction that will be built.

CHAPTER 5: MATERIAL AND WORKMANSHIP

5.1 Contractor's Risk to Perform

On a fixed price contract, the contractor is responsible for performing all work that is specified in the contract drawings and written contract documents for a fixed sum of money that is represented by his bid. This type of contract places the maximum amount of risk on the contractor.

If a contractor underestimates the amount of time and materials necessary to perform the work, he will lose money unless he can reduce his costs. The cost to perform the work can only be decreased through an increase in the contractor's efficiency or by cutting corners and doing less work or lower quality work than is specified in the contract.

A knowledgeable inspector representing the owner will be able to detect inferior materials or non-conforming work and report them to the project manager or contract administrator. The key to eliminating inferior materials and poor workmanship lies in the contract documents, the inspector's and contractor's familiarity with the required quality of materials and workmanship, and the inspector's and contract administrator's ability to ensure the contractor performs according to the contract.

5.2 Measuring and Enforcing Performance

In federal contracts, there are several key contract clauses* in addition to the written technical specifications that allow the contract administrator to ensure that the contractor is performing

quality construction.

5.2a Material and Workmanship Clause ⁴⁰

The material and workmanship clause requires that all material that is to be incorporated into the work be new and submitted to the contracting officer for approval. The clause also states that if any material in the contract is referred to by trade name, make or catalogue number, it is for the purpose of establishing a standard of quality and not meant to limit competition. The contractor has the option to use any material that in the judgement of the contracting officer is equal to that named in the specifications. Right away this presents a potential problem. For example, if a contract specification mentions a toilet manufactured by company A, and the contractor submits for approval a toilet manufactured by company B, the contracting officer will have to make a judgement as to whether toilet B is equal to toilet A. This judgement is likely to be subjective as both toilets will probably serve the design function. The contractor operating under the philosophy of minimizing his costs to maximize his profits has probably submitted the least expensive toilet he could find that would do what a toilet is supposed to do. The contracting officer may select toilet A. If this happens, there is likely to be a disagreement from the contractor. The contractor's remedy is to ask for a contracting officer's decision* in regards to the toilet meeting the specification. If the contractor still does not like the answer of the contracting officer he will have to file a claim

(see chapter 12 for discussion of claims).

Brand names do not necessarily represent a level of quality. The function of the product should be specified. In the toilet example, it may be appropriate to specify dimensions, flush capacity or that the toilet conform to nationally recognized testing standards such as ANSI* or ASTM*.

Thus, if the contracting officer can make an objective decision as to whether toilet B is equal to toilet A, there never should have been a brand name mentioned in the specification. Performance or design requirements should be used to specify a material. Most times the inclusion of brand names in federal contracts is a carry over of design firms that are used to designing private sector jobs or just plain laziness on the part of the designer, but this is not always the case.

A recent contract at the Naval Academy involved the replacement of numerous hot water heat exchangers and piping. The contract specifications required a heat exchanger with coils configured in the vertical position. A brand name was not mentioned in the specifications but it was pretty clear by the features that the designer chose to specify for the heat exchanger that only one type of product would meet the contract requirement. After bids were opened, the contractors' bids were compiled and compared to the government estimate. All of the bids were well above the government estimate. Several of the bidders commented that there were other products on the market that would perform the

function but that they had bid on the specified product and that was the reason for such high bids. All of the bids were rejected as being excessive and the project specifications were modified to permit a wider variety of heat exchangers. The project was readvertised and bid. The new bids reflected a significant amount of savings over the previously bid project. Upon further investigation, it was found that the designer had originally received help from a supplier in formulating the specification for the heat exchangers. This particular supplier was the only local source for the vertical heat exchanger. It appears that the supplier knew that he was the only source and expected all of the contractors to get quotes from him for the heat exchangers. Since there was no direct competition it appears that he was prepared to charge as high of a price as he thought he could get away with and still receive the orders. This last example serves to point out that it is not always the contractor that will try to cut corners by using inferior materials, but the opposite may happen before the contractor bids the job. If the specification would not have been revised, the government would have in all likelihood received the vertical coil heat exchangers at an inflated price that is simply passed on to the tax payers in the form of higher taxes or fewer construction projects being built for the benefit of the federal government.

The material and workmanship clause also states that all work shall be performed in a skillful and workmanlike manner but does not define skillful and workmanlike. The technical specifications

should describe the procedures for installing the material or performing the work. In the absence of well defined specifications for the execution of the work, industry standards are expected to be followed. This may sound rather vague but many trade associations have standards that workers in the industry are expected to follow.

5.2b Inspection of Construction⁴¹

This clause requires that the contractor set up and maintain an adequate inspection system to perform inspections that will ensure that the work performed conforms to contract requirements. The contractor is required to maintain written records of inspections performed and turn them over to the government. This clause does not define an adequate inspection system. Section 1400 of Navy construction contract specification describes the organization and testing requirements that a contractor is required to maintain. On large federal contracts, typically over two million dollars, the contractor will employ a person who is solely dedicated to quality control. This quality control person is on the job site at all times and reports to an officer of the construction company not to the job site superintendent. This arrangement eliminates any possible conflicts of interest between the job site superintendent who is more likely to be concerned with meeting a schedule than with quality, and the quality control representative.

In addition to the tests that the technical specifications direct the contractor to perform, the government maintains the

right to perform further inspections and tests as the contracting officer deems necessary. The contractor is obligated to remove and replace any work or materials that are found not to conform to the contract requirements. This clause gives the government the right to require the contractor to remove existing work for inspection. If the existing work is found to meet contract requirements, the government will pay to have the contractor repair any damage, otherwise the contractor is responsible for the cost to repair the work.

Since the contractor is responsible for performing all of the tests and inspections, it is important that the government contract administrator has confidence in the contractor's quality control organization and procedures. A situation of the fox guarding the henhouse has a potential to exist. Put another way, it is very easy for a contractor to falsify test and inspection results. Technical specification sections contain details of the required tests and inspections. The contract administrator should assure himself that the contractor is aware of the requirements and has an organized plan or approach for performing and recording tests and inspections.

5.2c Buy American Act - Construction Materials⁴²

The Buy American Act (41 U.S.C. 10) directs the government to give preference to domestic construction materials. The clause is rather short except for several definitions and is reproduced below:

"The contractor agrees that only domestic construction material

will be used by the contractor, subcontractors, materialmen, and suppliers in the performance of the contract, except for foreign construction materials, if any, listed in this contract."

With more and more countries entering the industrial stage, it is becoming quite commonplace that construction materials are made outside of this country. Most technical sections of specifications in federal contracts instruct the contractor that construction materials are to be brought to the site in the original containers. Although this wording was probably intended more for the protection of materials at the job site, it can help the inspector in recognizing foreign construction materials, as most boxes and cartons contain information about the manufacturing company and country of origin. Most large pieces of machinery or equipment will have identification or nameplates that will show the country of origin.

5.2d Counterfeit Bolts

The most important property of bolts used in construction is strength. Bolts of different strengths contain different markings on their heads. A counterfeit bolt is a bolt that looks like a legitimate bolt and contains all of the markings that would indicate it is of a certain strength but when subjected to a load test will fail before it reaches the strength indicated by the markings on the bolt head. Counterfeit bolts are dangerous and potentially could cause catastrophic damages if they are relied upon in structural members.

A judge recently sentenced a defense contractor to three years

in prison and fined him \$750,000 for faking quality tests on engine bolts used in military and commercial aircraft. Prosecutors of the case contend that the contractor saved more than \$ 1.5 million by failing to properly test some 9 million bolts between 1979 and 1989.⁴³

5.2e Owner's Rights in Regard to Substitution of Materials

In federal contracts, the government has the right to expect that the contractor furnish the materials that are specified in the contract. If the contractor furnishes materials that do not meet the specification, the contracting officer may require that the contractor remove the materials and replace them with materials that conform to the contract requirements.⁴⁴ In many instances, such as with bolts, the contract requires that the contractor provide a certificate from the manufacturer stating that the material meets the requirements mentioned in the specifications. If it is found that the material in fact does not meet the requirements of the specification, the manufacturer may be liable for trying to defraud the government (supplying false certifications).

In other instances, where it is found that materials are installed that do not meet the contract specifications, the contracting officer may not require the contractor to remove the materials but may require the contractor provide a price credit in the amount of the difference between the materials that were

installed and those specified. This assumes that the contractor has installed material that is cheaper than that specified in the contract. This is usually the case, as it was previously stated that contractors under a fixed price contract operate to minimize costs.

5.3 Conditions Conducive to Material and Workmanship Problems

In August 1986, the defense department's Office of the Inspector General issued a research report on unauthorized quality assurance practices by contractors. The report concluded that in 22 of 24 DOD investigation cases studied, the contractors intentionally and knowingly delivered or planned to deliver products that were not in conformance with contract requirements. Some other indicators and conditions conducive to unauthorized quality assurance practices include:⁴⁵

- 1) A history of poor performance by the contractor (remember that a contractor is driven by the profit motive and that a poor performer is probably losing money and will be looking for areas to cut costs).
- 2) Negative pre-award survey (if other customers have had problems with this contractor, there is a chance that problems will continue in the future).
- 3) Awards to unusually low bidders (extremely low bid does not allow a large margin for profit).

- 4) Government quality assurance representatives (inspectors) reliance on contractor falsified documentation.
- 5) Insufficient government quality assurance practices. (often the government will not perform any inspections but will rely on the contractor certification and documentation).

The DOD Office of the Inspector General's report was not specific for construction (report was for all purchases made by DOD) but contained many findings that are directly applicable to construction.

5.4 Closing Thoughts

Product substitution cases sometimes involve government employees. For example, gratuities and bribes have been paid to government inspection personnel to accept items which do not conform to contract requirements.

CHAPTER 6: CHANGES AND MODIFICATIONS

6.1 Background

Sometimes it is necessary during the construction project to make changes to the design that cause the contractor to perform additional work. An owners actions or lack of certain actions may also cause the contractor to perform extra work or incur additional costs. When all aspects of this additional work are agreed upon by both parties it is put in writing and becomes a modification to the contract. The contract clauses and general conditions will govern the circumstances in which the contractor is entitled to additional compensation.

6.2 Changes Clause⁴⁶

This clause gives the government the right to make changes within the general scope of the contract including changes:

- 1) In the specifications (including drawings and designs).
- 2) In the method or manner of performance of the work.
- 3) In the government-furnished facilities, equipment, materials, services or site.
- 4) Directing acceleration in the performance of the work.

If any of the above changes causes an increase or decrease in the contractor's cost of the performance of any part of the work under the contract, the contractor is entitled to an equitable adjustment*, and the contract will be modified in writing.

The contracting officer may make an interpretation or determination that causes the contractor to incur additional costs. The contracting officer's interpretation may be that the contractor

is already required by the contract to perform the work, in which case the contractor will not be entitled to an equitable adjustment under this clause. If the contractor appeals the contracting officer's decision and wins, he will be compensated for his additional work. The contractor is not only entitled to additional compensation for the extra work but also for additional costs if incurred for work that was not changed. An example of this is the owner's requirement for additional site work that pushes the contractor's roofing into the winter season. Performing roofing under these circumstances is likely to be more expensive and the contractor will be entitled to his additional allowable costs*.

Any written or oral order which also includes direction, instruction, interpretation, or determination that causes a change shall be treated as a change order provided that the contractor gives the contracting officer written notice stating the date, circumstances, and source of the order and that the contractor regards the order as a change order. The contractor is only eligible to recover his costs for a period of twenty days before he gives notice to the contracting officer. Cases in which there is disagreement over whether it is a change or not will be discussed in chapter 12. It will be assumed for the moment that the owner has either caused or requested a change.

6.3 Types of Changes

Below is a list of some of the types of changes that can be expected in construction:

- a) Additional work - The owner has requested that the contractor

perform additional work on the job. The work must be within the general scope of the project. Adding additional electric outlets is considered within the general scope, building another identical building next door under the same contract is not. The interpretation of the general scope is fairly broad but the above examples serve as the two extremes.

b) Ripple effect - A change to one type of work effects the performance of another type of work. For example, additional site work pushes the roofing work into winter.

c) Delay - The job or some portion of the work has come to a halt or will take longer because of the owner's action or lack of action. For example, the owner may not review and return the contractors material submittals in a timely manner causing the contractor to fall behind schedule and incur additional overhead costs for being on the job a longer period of time than expected.

d) Change in methods - Typically there are no limitations placed on the contractor as to how he may perform the work. It is assumed that he will be motivated by profit and choose the most efficient method and pass on the lower cost to the owner in the form of a lower bid. Restrictions on a contractor's performance methods should be mentioned in the specifications. Typical restrictions may include certain work hours or that the contractor must only work on one phase at a time.

e) Differing site conditions - There are two types of differing site conditions that a contractor may encounter:⁴⁷

I) Subsurface or latent physical conditions at the site which

differ materially from those indicated in the contract

II) Unknown physical conditions at the site, of an unusual nature, which differ materially from those ordinarily encountered and generally recognized as inhering in work of the character provided for in the contract.

f) Acceleration - The owner may want the contractor to speed up progress on the job and finish at an earlier date than the contract specifies.

g) Defective specifications - A defective specification is one in which the performance is impossible or so economically unfeasible as to render its performance impossible. Technical incompetence of a contractor does not make a specification defective.

6.4 Pricing of Change Orders

The government will send out a written request for the contractor to provide a cost proposal for the types of changes mentioned under paragraphs a, d, and f above. The contractor is responsible for notifying the contracting officer that he has encountered a change of the type in paragraphs b, c, e, and g in order to be eligible for compensation. No changes to the contract will be made after the contractor has received his final payment.

6.5 Contractor's Proposal: Modification of Proposals- Price Breakdown⁴⁸

This contract clause requires that the contractor provide a price breakdown for additional work. The exact format of the price breakdown is left up to the contracting officer. The clause states

that the proposal shall be in sufficient detail to permit an analysis of all material, labor, equipment, subcontract, and overhead costs, as well as profits and shall cover all work involved in the modification. Appendix A is a sample form for cost proposals used for Navy construction contracts. It is typical that contractors will break the work down into unit quantities (square feet of floor tile, linear feet of pipe, etc.) and will furnish unit prices for labor, materials and equipment and price overhead and profit as a percentage of their labor, material, and equipment costs. This type of breakdown has a distinct advantage over lump sum pricing of changes. Materials are sold through suppliers on a unit basis (square foot, linear foot, etc.) and most estimating manuals report labor productivity in terms of units of output per hour or hours per unit of output.

This unit pricing allows direct comparison between the contractor's estimate and the government engineer's estimate prepared using published unit prices in various estimating manuals. When costs are a factor in any determination of a contract price adjustment, such costs shall be in accordance with part 31 of the FAR and the DOD FAR Supplement.⁴⁹ Part 31 of the FAR contains costs that are allowable as part of a contract change. Typical allowable costs include:

- 1) Materials (less any discount or rebate) including delivery and sales tax.
- 2) Labor (reasonable for work performed, i.e. not \$100/hour for a plumber).

- 3) Equipment, rental or ownership and operating expenses.
- 4) Depreciation.
- 5) Economic Planning.
- 6) Insurance.
- 7) Labor relations.
- 8) Employee morale, health, and welfare.
- 9) Maintenance and repair of property.
- 10) Bonding.
- 11) Cost of money.

Disallowable costs include:

- 1) Bad debts.
- 2) Contr'butions or donations.
- 3) Entertainment.
- 4) Fines, penalties.
- 5) Interest on borrowings.
- 6) Legislative lobbying.
- 7) Loss on other contracts.
- 8) Income taxes.
- 9) Advertising (except as directly related to the contract, i.e. help wanted ads).

Items 1, 2, 3, and 10 of the allowable costs are considered direct costs and can be traced directly to the job. The remaining items are considered overhead items. A contractor may lump all of these costs together with the unallowable costs in figuring his home office overhead costs but should still have records that show the make up of the overhead costs available.

6.6 Negotiating the Change: Cost and Pricing Data

Changes or modifications to the contract are negotiated with the contractor. The contractor is in the best position to estimate what his actual costs are expected to be for the changed work. Many contractors maintain historical records on past work performance and should be able to estimate within a narrow range the cost of performing the work. Since the contractor has more knowledge than an owner in the area of estimating his costs, a potential situation exists for the contractor to deliberately overestimate the costs for the work and overcharge the owner.

In 1962, Congress passed the Truth in Negotiations Act. The act required the submission of current and complete cost and pricing data to the government prior to the pricing of a change or modification of any contract if the price adjustment is expected to exceed \$100,000, or any lesser amount if so prescribed by the agency head*.

Cost and pricing data means all facts as of the date of price agreement that prudent buyers and sellers would reasonably expect to affect price negotiations significantly. Cost and pricing data are factual, not judgmental, and are therefore verifiable and include items such as: a) vendor quotations b) nonrecurring costs c) unit cost trends such as those associated with labor efficiency. Under the Truth in Negotiation Act, the contractor is required to certify that, to the best of his knowledge and belief, the data submitted is accurate, complete, and current. The act allows a price reduction based on the amount of overpricing due to

defective data submissions. If the submission of data was intended to mislead the government, the government may reduce the contract price by double the amount of the price increase which resulted from the contractor's submission of defective data. The contractor may also be prosecuted for knowingly submitting defective data under other federal statutes that are discussed in chapter 12.

Some of the ways in which inaccurate higher price data have been submitted to the government include:⁵⁰

- 1) Using blank quotation forms obtained from material vendors.
- 2) Obtaining quotations at book or catalogue prices which were higher than the costs known to the contractor.
- 3) Not disclosing rebates received from vendors on purchases.

It is important that the contract administrator review in detail the contractor's proposal for a change. The proposal should be reviewed to determine if any of the above mentioned conditions of inaccurate pricing exist. Also the proposal should be reviewed to determine if there are work items that the contractor is charging as additional work that should be included in the base contract* and the contractor is already required to perform. The costs being submitted should be verified to ensure that they are allowable. This may require that the contractor submit an annual report or statement that breaks down his overhead costs into categories as overhead usually appears on an estimate as a percentage of direct costs.

It is much easier to verify the correct price for materials than labor by calling several suppliers or looking in published

price catalogues for similar types of materials. Just because a contractor has submitted a proposal with what appears to be a high labor cost does not mean that the contractor has submitted inaccurate pricing data or is trying to mislead the owner. The contractor may be unfamiliar with the type of work being requested in the change and the high price represents his lack of skill in performing that type of work and hence his element of risk. Labor prices can be verified if it is known that the contractor has historical labor records or if the changed work is similar to that being performed on the base contract. The contracting officer can examine any of the contractor's records that he deems necessary to determine if the cost and pricing data submitted is accurate .⁵¹ For DOD contracts, the Defense Contract Audit Agency (DCAA) can be called to assist the contracting officer in reviewing the contractor's records. A typical request of the DCAA is the verification of home office overhead for a contractor.

CHAPTER 7: PAYMENT PRACTICES

7.1 Failure of Owner to Pay Contractor

The failure of an owner to pay a contractor is one of the most significant ways in which an owner can breach a contract. To determine if a breach in the contract has occurred, information surrounding the owner's decision to not make payment must be known. There are several justifiable reasons why an owner might refuse to make payment or withhold a portion of the payment:

- 1) The contractor is behind schedule.
- 2) Contractor has billed for more work than is actually installed.
- 3) Contractor work or material is of questionable quality.
- 4) Contractor is billing for work that was never performed.
- 5) Administrative error.
- 6) Labor violations on job.
- 7) To protect the interests of the owner.

There are also several other not so justifiable reasons why an owner may not pay a contractor:

- 1) Owner is having financial or cash flow problems.
- 2) Owner is using superior financial position as a bargaining tool to negotiate with contractor or persuade contractor to do something as a further condition of payment.

The legitimate reasons cited above should be relatively easy to verify.

7.1a The contractor is Behind Schedule

The contractor submitted schedule can be checked to determine

if the project is on schedule or behind. In federal contracts it is the contractor's responsibility to submit a schedule for the government's approval and to maintain an updated copy.⁵² If the contractor does not submit a schedule, the contracting officer can withhold approval of progress payments until the required schedule is submitted. It is also the contractor's responsibility to break down the project into work packages and indicate units, quantity, and price for each unit of the work package.⁵³ This is commonly referred to as the schedule of prices. The owner can use the schedule of prices to compare the amount that the contractor is requesting for payment with the amount that should be paid according to the actual quantity and type of work that is completed. The actual quantity that is complete can be compared with the total quantity listed on the schedule of prices to determine a percentage of completion for that work item. This percentage of completion can be compared to the contractor's schedule to determine if the project is behind schedule for that item.

7.1b Contractor has Billed for More Work Than Is Actually Installed

A field survey of actual units completed compared with the amount of units the contractor claims are complete will determine if the contractor has billed for more work than is actually completed. This is not necessarily a sign of fraud. The contractor may have been a little over anxious about billing in order to improve his cash flow or may have simply made an error in

submitting the bill for payment. Most contractors bill on a monthly basis on government contracts. These billings are sometimes prepared up to a week in advance based upon a quantity that the superintendent projects will be installed.

7.1c Contractor Work or Material Is of Questionable Quality

The quality of the materials is a possible gray area requiring interpretation of the contract specifications. The actual decision of whether the material meets the specifications should have been made well in advance to the material being installed. Government contracts require the submission of all materials to be incorporated in the contract for the approval of the contracting officer.⁵⁴ To determine if the installed material is of acceptable quality should only entail comparing the installed material with the approved submittal*.

The determination of whether the workmanship is acceptable requires an interpretation of the contract specification. The contractor is only required to meet the minimum specified criteria. In the absence of a well defined specification for workmanship, a contractor can be expected to comply with workmanship that is standard for the industry. The industry standards are often published by a trade association or may be techniques that have evolved over time as acceptable practices. For example, it is perfectly acceptable for paint on a wall to have a non-uniform appearance up close. The acceptable industry standard is to stand back five feet and look at the wall, any defects observed from this distance require correction. The five feet inspection rule is not

referred to in the paint specification. A typical paint specification will state that the paint is to have a uniform appearance but will not define uniform.

7.1d Billing for Work That Was Never Performed

Billing for work that was not performed differs from billing for more work than is actually installed. In the latter case the contractor has the intent to perform the work. The first case is fraud. A typical case is when a contractor submits a bill to the owner for additional compensation (change order or extra) for work he claims to have performed that was not part of his contract. The government is protected from this practice by the differing sites condition contract clause. This clause states that the contractor shall, upon encountering a condition that differs materially from that described in the contract or from that which is typically to be encountered, immediately notify the contracting officer in writing.⁵⁵ This notification allows the contracting officer to observe the differing condition and make the decision that would minimize cost and best solve the problem. Without this notification by the contractor the government is not responsible for compensating the contractor. Although the contract clause states that written notification must be made by the contractor before he proceeds, if it can be shown that the contracting officer had knowledge of the differing condition and remained silent while the contractor proceeded, then the contractor will probably be able to receive payment for the extra work. The penalties for this type of fraud are discussed in chapter 12.

7.1e Administrative Error

An administrative error may be the reason why a contractor does not receive payment. While this may be an honest mistake with no ill will intended, it is still likely to disrupt the contractor's cash flow and the contractor may be entitled to extra compensation in the form of interest because of the delay in receiving payment. The government prompt payment contract clause requires the government to make payment to a contractor fourteen days after receiving a correct and complete invoice for payment. If payment is received late by the contractor, the contractor will receive interest on the payment. The interest rate is set every six months by the Treasury Department of the United States.⁵⁶

7.1f Labor Violations

Under federal construction contracts, payment may be withheld from the contractor in such an amount that is necessary to pay laborers and mechanics employed by the contractor or any subcontractor the full amount of wages required by the contract.⁵⁷ This type of withholding occurs when contractors are not paying their employees in accordance with wages established by the Davis Bacon Act.

7.1g Withholding to Protect Owners Interest

This is a broad category and encompasses such areas as withholding payment because a contractor has caused damage to the facility and has yet to make the necessary repairs. Another example would be the installation of a mechanical system. The mechanical system may be 100 percent installed but it has not yet

been tested. The owner does not want to pay the entire 100 percent until he has an assurance that the system is operating as designed. The payments under fixed-price construction contracts clause gives the contract administrator the authority to withhold up to 15 percent of a payment until the contract administrator is convinced that satisfactory performance has been achieved.⁵⁸

7.2 Obligation of Payment

The duty to pay a contractor is a serious obligation. A small contractor will not be able to finance large amounts of money for long periods of time and may go out of business if payments are not received shortly after an invoice for payment is submitted. Some owners take advantage of this situation by using their superior financial position (owner has money and is the one making payments) to get the contractor to perform extra work without compensation with the promise to expedite a payment or ensure that the payment makes it through the owner's bureaucratic payment system on time.

The owner should have all the financing arranged before the start of the project and should obtain additional financing if necessary to ensure that the contractor is paid on time.

A contractor working with the federal government will not have a problem concerning the owner's finances. Negotiating with a contractor based on any promises that his payment request will receive any special treatment is clearly a violation of the government standards of conduct (see appendix B for DOD standards of conduct).

CHAPTER 8: ORGANIZED CRIME

8.1 The Criminal Organization

When one hears the words organized crime, immediate thoughts of gangsters, the mob or the mafia along with gambling, drugs, and other highly profitable crimes come to mind. Organized crime simply means that there is a formal structured organization that coordinates and carries out criminal activities. The mafia is just one such organization.

8.2 Organized Crime's Involvement in Construction

Organized crime is also involved in construction. The extent of organized crime's involvement and influence in New York city is almost legendary. Organized crime is involved on many illegal activities that were previously discussed such as bid rigging and labor violations. It is well known that concrete in New York city is controlled by the mafia. A Connecticut contractor spent nearly three months preparing a bid for the concrete portion of Manhattan's new \$486 million Jacob K. Javits Convention Center. The Connecticut contractors bid would have been under the \$31 million bid submitted by S & A Concrete Company if he would have bid on the job. He dropped out of the bidding at the last minute after a visit and a couple of phone calls from several associates of convicted crime boss Anthony Salerno (part owner of S & A Concrete).⁵⁹

The construction industry in New York city is so plagued by crime and corruption that New York governor Mario Cumo formed a

special construction industry strike force consisting of about 100 prosecutors, investigators, accountants, and analysts.

Labor officials are often involved in organized crime. Corrupt labor unions are often the enforcement arm of organized crime. Teamsters in New York have often slowed or blocked delivery of building materials to builders who do not pay extortion fees. There have also been labor disruptions at jobs not paying kickbacks to organized crime. The costs that the labor unions extract from the contractors and subcontractors are passed on to the developers and owners resulting in higher construction costs. Money that is paid towards union benefits such as pension and insurance is often diverted to the pockets of corrupt union officials. Companies run by organized crime have been able to cut costs by not paying benefits and thus are able to under bid competition. The victims of organized crime include: union members, owners, and builders.

New York city's numerous statutes and building codes have contributed to corrupt practices in the building industry. An organization with control over suppliers, union officials and city inspectors can improve the speed and efficiency of the construction process. Thus it can be said that organized crime does deliver a product, a guarantee against delays, and labor unrest. For a price, contractors are even allowed to use non-union labor. Contractors performing work without organized crime's approval (not paying extortion fees) would often find portions of their work ripped out. The influence of organized crime is almost like a tax. Contractors often find it easier to roll over and pay the extortion

fees and pass the cost on to the customer than to fight through the legal system. If all contractors are paying extortion fees, the fees work just like a tax. All contractors would have a mandatory fixed cost to add to their bid. The real losers become the owners who are paying the higher construction costs and the workers who are not receiving union benefits.

8.3 Fighting Organized Crime

Eliminating the influence of organized crime is difficult, few victims are willing to cooperate for fear of physical harm. The Racketeer Influenced and Corrupt Organization Act (RICO) passed in 1970 was designed to seek the eradication of organized crime by providing new remedies to deal with its unlawful activities. The act makes it illegal for any persons who have received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of unlawful debt to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce. In other words, it is illegal for the criminal organization to operate a legitimate business that is established from the money generated from the illegal activities of the criminal organization. Racketeering is defined in the act as: any act or threat involving murder, kidnaping, gambling, arson, robbery, bribery, extortion, or dealing in narcotic or other dangerous drugs, which is chargeable under state law and punishable by imprisonment for

more than one year. Racketeering in construction consists mainly of bribery and extortion. Freelance racketeering is almost as common as that related to mafia families. Under RICO assets can be seized from racketeers.

Some companies have become fed up with racketeering and will not undertake any new building projects in an area known to be riddled with corruption. In one case, a large New Jersey corporation was planning to expand but did not want to build in New Jersey.⁶⁰ Company executives cited the reasons as not wanting to go through the same ordeal as the last time they built: job site prostitution, loan shark rings, kickbacks, and sweetheart contracts for favored suppliers.

The governor of New Jersey received word of the corporation's plan to build out of state and called in the newly formed division of criminal justice. The Criminal Justice Division set up a meeting with company executives. The company executives agreed that if anyone approached them with a corrupt offer they would cooperate fully with law enforcement officials. Rather than stake out the construction site looking for corruption, a different approach was tried. The Criminal Justice Division worked with the company to set up procedures that would preclude corruption. Some of the recommendations of the Criminal Justice Division included:

- 1) Use buddy system for meetings with worrisome outsiders who might be reluctant to make a corrupt offer or threat with more than one company witness present.

2) Set up formal procedures for awarding construction contracts in which the decisions seem to be made at a much higher level than the front line. This gives the front line employees an out if he is pressured to come through with a contract for a certain supplier or subcontractor.

3) Keep checks and balances separate (i.e. audit staff separate from contract award staff), labor negotiator who only has authority to deal with unions and no other phases. This will deter a corrupt union from demanding contracts for friendly suppliers as the price of labor peace.

When a potential criminal sees that the system is tight, it tends to discourage an approach. Tight procedures enforced from the top to the bottom of a corporation send out the message that such an approach will not be tolerated.

An owner or contract administrator who believes that organized crime's influence is present at their project should not take matters into their own hands. The owner or contract administrator should notify the proper authorities as to the criminal activity. As mentioned previously, many people are reluctant to be witnesses because of the threat of physical violence. The other chapters in this paper have presented unethical and fraudulent acts that were for the most part committed by a single contractor acting alone (exception would include bid rigging) and did not involve the contractor trying to extort money from an owner under the threat of violence.

CHAPTER 9: LABOR CONCERNS

9.1 Introduction

There are numerous labor laws and regulations that are specific to federal government contracts. The consistent enforcement of these labor laws is important to maintain the integrity of the federal contracting system. A contractor that does not abide by the required labor laws and regulations has an unfair cost advantage over competitors that abide by the rules.

9.2 Contract Work Hours and Safety Standards Act (40 USC 327-333)⁶¹

This act requires that contractors on all government contracts over \$ 2,000 pay laborers* and mechanics* at a rate of at least one and one half times the basic rate of pay for any work over 40 hours per week.

9.3 Davis Bacon Act (40 USC 2769-2769-7)⁶²

This act requires that no laborer or mechanic employed upon the site of work shall receive less than the prevailing wage rates as determined by the Secretary of Labor. Prevailing wage rates for a specific geographic area are calculated by Department of Labor surveys and are incorporated as part of the contract documents. This act is applicable to all federal government and District of Columbia construction contracts over \$ 2,000. Under this act laborers and mechanics are to be paid not less often than once a week. This act does not apply to managerial type workers, or sub-professional workers such as surveyors.

9.4 Copeland Act (Anti Kickback Act) (18 USC 874, 40 USC 276c)⁶³

This act makes it unlawful to induce by force intimidation, threat of dismissal from employment, or otherwise, any person employed in federal construction projects to give up any part of the compensation to which that person is entitled under a contract of employment. This act also requires contractors and subcontractors to furnish a statement of compliance with respect to the wages paid each employee during the preceding week.

9.5 Enforcement of Labor Standards Provisions

Contractors and subcontractors are required to submit weekly payrolls and statements of compliance for each week in which work was performed on the project to the contracting officer.⁶⁴ The payroll records shall contain the name, address, social security number of each worker, his correct job classification, hourly rate of wages paid (including rates of contributions or costs anticipated for bona fide fringe benefits or cash equivalents), daily and weekly number of hours worked, deductions made, and actual wages paid.

The payrolls are a main source of data the contract administrator can use to determine compliance with the labor laws. Interviews with the contractor's employees can be used as a method of verifying the payroll data. Contractors are required to submit some type of daily report to the contracting officer, the exact format is usually specified in the general requirements of the contract. Daily reports on Navy construction contracts contain

information to be filled in about the number and type of workers on the job and hours worked. These daily reports can be compared to the weekly payrolls to ensure consistency. A sample of a daily report form used on Navy construction contracts is presented in appendix C.

The contracting officer can withhold payment to a contractor who fails to submit the required payrolls.⁶⁵ The amount of payment withheld is an amount that the contracting officer feels will protect the interests of the government and employees of the contractor or any subcontractor. Payment may also be withheld if it is found that the contractor underpaid his employees or did not pay overtime in accordance with the Contract Work Hours and Safety Standards Act.

9.6 Investigations

The contracting officer is required to perform an investigation if a compliance check indicated that violations may have occurred that are substantial in amount, willful, or not corrected.⁶⁶ Simple errors that are discovered and corrected when brought to the contractors attention are usually dismissed as being administrative errors if no employee complaints are uncovered. The investigation is forwarded to the Administrator, Wage and Hour Division of the Department of Labor within 60 days of the completion of the investigation.

A contract administrator should be alert to instances in which daily reports do not reconcile with weekly payroll statements, or employees that perform work on the project do not appear on any

payroll for the prime contractor or any of the subcontractors.

If substantial evidence is found that the violations are willful and in violation of a criminal statute (usually 18 USC 874 or 18 USC 1001, false statements) the report is forwarded to the Attorney General of the United States for prosecution if the facts warrant.

There are likely to be disagreements between the contracting officer's interpretation of the labor laws and the contractor's interpretation. Such disagreements are not handled in the same manner as other disputes (Disputes clause, FAR 52.233-1). The contractor can appeal the contracting officer's findings to the Administrator, Wage and Hour Division of the Department of Labor directly.

9.7 Penalties

A breach of the labor law requirements may be grounds for terminating a contractor and seeking to debar that contractor from future contracts for a given period of time as provided for in 29 CFR 5.12.

9.8 Employee or Subcontractor ?

Many contractors try to cut costs by claiming that certain workers are subcontractors and not employees. Contractors are required to pay workers compensation, social security, and unemployment insurance for each of their employees. By claiming that the worker is a subcontractor, the contractor can avoid these required insurance costs. These insurance costs can often amount to more than 25 percent of a workers total pay. Contractors that

try to claim workers are subcontractors have an unfair competitive advantage and in many cases are probably violating the law.

A worker is considered an employee under the federal tax code if an employer has the right to discharge the employee and supplies the employee with tools and a place to work. For an independent subcontractor, the employer has the right to control or direct only the result of the work and not the means and methods of accomplishing the result. As mentioned previously, the contract administrator should pay attention to the contractor and subcontractor submitted payrolls to ensure that all workers appear. Federal contracts also require that all contractors and subcontractors submit proof of insurance. This is usually satisfied by the contractor's insurance agency submitting a certificate of insurance. A certificate of insurance will further substantiate that a worker is a legitimate subcontractor. Other simple tests such as noting if the worker has a vehicle with a name or logo other than that of the prime contractor can be used to determine if a worker is a subcontractor.

9.9 Closing Thoughts

Enforcement of labor laws adds more work to an often overworked contract administrator and government inspector. A brief meeting with the contractor to discuss all labor requirements is a good idea and is discussed in chapter 13. It is easy to ignore labor regulations when none of the workers are complaining. The view that the enforcement of the labor regulations does not add to the overall quality or timeliness of the project but only takes

time away from other inspection and administration duties is easy to develop.

An effective method of enforcement shifts the responsibility for labor compliance entirely to the contractor where it belongs. If the contract administrator uses the procedures allowed by the contract to reject an invoice for payment or withholds a sum of money when the labor regulations are not being followed, then contractors will start off with the right attitude towards complying with the labor laws. The contractor must sense that the contract administrator and government inspector are committed to enforcing all of the provisions of the contract.

Prevailing wages are typically only required on publicly funded construction projects. The Davis Bacon Act applies to federal projects. Many states have similar provisions for their public works projects. Recently, a number of California localities began enacting ordinances requiring contractors to pay prevailing wages on private projects.⁶⁷ This trend has upset many small contractors that are non-union and do not pay prevailing wages. The Golden Gate chapter of the Associated Builders and Contractors (ABC) has challenged the legality of the law in California state court. This issue is likely to generate many more challengers should localities try to adopt a requirement for prevailing wages for private sector jobs.

CHAPTER 10: MINORITY AND SET ASIDE CONTRACTS

The federal government has made it a policy to obtain a proportion of its construction needs with small business concerns and small disadvantaged business concerns.⁶⁸

10.1 Small Business

The size a company can be and still be considered a small business varies depending on the type of business.⁶⁹ General contractors are considered a small business if they perform less than \$ 17 million per year while for most special trades contractors \$ 7 million is considered a small business.⁷⁰ Contracting officers are required to set aside all construction contracts for small business concerns provided that it can reasonably be expected to receive offers from at least two responsible small business concerns and awards will be made at fair market prices. While this reserving of contracts for only small business is a set aside of contracts it is still conducted under competitive conditions under most circumstances using sealed bidding for a fixed price contract. The main goal in most government contracts is to promote competition. This goal can still be achieved with setting aside construction contracts for small businesses provided that there are enough small businesses interested in the work. Contractors certify that they are small businesses when submitting their bid to the contracting officer.⁷¹ The certification is accepted as being correct unless it is challenged by another contractor or the contracting officer has a reason to believe that the contractor is not a small business.

The Small Business Administration (SBA) will make a determination as to whether the contractor is a small business.

The SBA plays a role in determining if a contractor is responsible. The contracting officer can perform an investigation to determine if the contractor meets the responsibility requirements. If the contracting officer finds the contractor is not responsible, the contractor can apply to the SBA for a certificate of competency. A certificate of competency is a representation by the SBA that the contractor is a responsible contractor. The SBA sends a team to visit the contractor to determine if a certificate of competency should be issued.

10.2 Small Business Administration Contracts: 8 (a)

Section 8(a) of the Small Business Act (15 USC 637(a)) established a program that authorizes the SBA to enter into all types of contracts with agencies and let subcontracts for performing those contracts to firms eligible for program participation.⁷²

The SBA limits program participation to small disadvantaged business concerns. A small disadvantaged business (SDB) is a business concern that is at least 51 percent unconditionally owned by one or more individuals who are both socially and economically disadvantaged. "Socially disadvantaged" means individuals who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their qualities as individuals. "Economically disadvantaged" means socially disadvantaged individuals whose ability to compete in the

free enterprise system is impaired due to diminished opportunities to obtain capital and credit as compared to others in the same line of business who are not socially disadvantaged.⁷³ Black Americans, Hispanic Americans, Asian Pacific Americans, and Subcontinent Asian Americans, are considered socially and economically disadvantaged. The SBA determines if a contractor meets the requirements of a small disadvantaged business.

An "8(a)" contract can either be awarded with competition limited to 8(a) firms or by sole source procurement (exceptions to requirements for open competition are mentioned in chapter 2). An 8(a) contract is actually a three party agreement between the government, SBA, and the subcontractor. Contracting agencies can approach the SBA with contracts that they feel are appropriate for an 8(a) contract, or the SBA may contact various contracting agencies trying to place an 8(a) contractor with specific skills.

Public law 99-661 set contract goals for minorities within DOD and permits DOD to use less than full and open competition when practical and necessary to facilitate an achievement of a goal of awarding 5 percent of contract dollars to small disadvantaged businesses providing the contract price does not exceed the fair market price by more than 10 percent. The SDB is required to perform 50 percent of the work with his own forces. DOD awarded only 3.3 percent of its \$ 120 billion in prime contracts to SDBs in fiscal year 1989. Construction contracts carried a larger percentage of awards to SDBs with 9.8 percent or \$ 726.2 million of the \$ 7.4 billion in DOD construction contracts.⁷⁴

10.3 Administrative Concerns

As was discussed in chapter 3 (bid rigging), bid prices tend to increase as competition decreases or vanishes. The 8(a) program is set up to help small disadvantaged businesses get started and recognizes that these types of firms, because of the types of difficulties they experience, are not likely to be low bidders in an extremely competitive market, thus a 10 percent price buffer is allowed. For the program to succeed in performing its function a SDB must eventually become competitive and leave the program. A SDB is allowed to participate in the program for seven years.

It does not take a lot of insight to realize that 5 percent of the DOD budget is a lot of money. There are a lot of contractors that would like to be eligible for that big pot of money. The requirement that the SDB perform 50 percent of the work with its own forces does not specify that 50 percent of its workforce has to be minorities. A serious concern is that businesses would recruit a minority individual and on paper show him as 51 percent owner of the company.

10.4 Other Set Aside Programs

Many other public owners (state and local governments) have contract set aside programs. The qualifications vary from owner to owner with a common requirement that the agency set aside a certain percentage of its purchases and public works projects for

minority firms. The exact definition of which firms qualify as minority firms also varies. Women are considered minorities by some owners. Some contractors transfer 51 percent ownership of their company to their wives to qualify as a minority contractor. Clearly, this goes against the spirit of minority set aside programs designed to help minority contractors get established and eventually compete in the free market.

New Haven, Connecticut has a set aside program that requires 15 percent of any city construction contract to be set aside for minorities and 6 percent for women.⁷⁵ In addition, minorities must work at the site at least 25 percent of the time and women 6.9 percent. Projects can be shut down for noncompliance. The enforcement of such provisions has led some contractors to engage in what is known as "bicycling". Bicycling is the movement of minorities onto a jobsite or from jobsite to jobsite in order to satisfy minority contracting requirements. The counting of minority workers and hours worked can be an administrative nightmare for a contract administrator.

Grand Rapids, Michigan has a requirement that all contracts over \$ 10,000 will be awarded to the lowest bidder that can demonstrate that at least 10 percent of work would be performed by local minority business enterprises.⁷⁶

10.5 Case Studies

A recent case in federal district court ruled that the U.S. Army Corps of Engineers and the SBA violated federal law when 100 percent of the Corps projects in a district were set aside for SDBs

without considering the impact on other firms. The Corps had set aside 11 projects that represented all of the small business contracts in the Vicksburg area for 1981. The judge commented that the set aside "was highly unusual" and "should have invoked a responsible reaction in accordance with statutory and regulatory directives and not simply acceptance blinded by zeal or pressure" to boost minority contracting. This case is different from past cases brought about by contractors in that the plaintiffs were precluded from any participation whatsoever. One of the contractors that brought the suit typically received about six projects a year from the Corps ranging from \$ 750,000 to \$ 2 million.

In 1989 in *The City of Richmond vs J. A. Croson Co.* the U. S. Supreme Court declared invalid Richmond's minority contracting program and required localities to document past discrimination in order to justify their race and sex based contracting programs. Set aside programs have to be designed to remedy the effects of proven past discrimination in contracting. The Croson decision did not affect federal contracting programs.⁷⁷

Minority contractors are organizing and bringing suits against agencies that they feel do not make an effort to award contracts to minorities. Contractor groups such as the Associated Builders and Contractors (ABC) are upset about set aside programs claiming that they lockout non-SDB firms from a substantial portion of the available construction contracts. Many contractor groups are challenging local set aside programs in the wake of the Croson

decision.⁷⁸ U.S. District Court Judge Louis Bechtel permanently enjoined Philadelphia from enforcing its eight year old ordinance of requiring prime contractors to set aside 27 percent of all subcontracts for disadvantaged firms, with 15 percent going to businesses owned by ethnic minorities, 10 percent to women and 2 percent to handicapped.

Atlanta's program of awarding 35 percent of value of city construction contracts was struck down by Georgia's supreme court shortly after the Croson decision.⁷⁹

Not all challenges to set aside programs are successful. Seattle District Court Judge William J Dwyer upheld King County's minority and women owned business enterprise plan (MWBE) which gives MBWEs a 5 percent bid preference.⁸⁰

The Army has discovered several cases of fraud in the past several years in contracts under the 8(a) program.⁸¹ At least a dozen contractors have been charged. Guidelines for the Army Corps 8(a) programs typically require at least 20 percent of the work to be performed by the minority contractor. Auditors often find a secret agreement where a minority firm negotiates a contract for an inflated price and then subcontracts the work to another company that is not minority owned but is better capitalized. The two then split the profit. One of the auditors believes that there may be a systemic problem because many of the 8(a) firms don't possess the equipment and expertise to do the job. Some minority contractors perceive the punishment of the fraud as honest contractors being punished because of a crackdown of inadvertent technical violation

of federal procurement rules.

10.6 Closing Comments

Proof of prior discrimination is required for a set aside program to comply with the Croson decision. Many set aside programs across the country have been challenged and found to be illegal in accordance with the Croson decision. In Atlanta, the minority contractors share of city contracts fell from 36 percent in the first third of 1989 to 14.5 percent in the last third.⁸²

Set aside programs will continue to be a controversial issue and will likely continue to generate challenges across the country. Contract administrators need to be alert to ensure that minority firms that are afforded special opportunities are legitimate firms and not just front organizations set up to capitalize on a government program.

Chapter 11: CONSTRUCTION SAFETY

11.1 Responsibility for Safety

Each employer shall furnish to each of his employees, employment and a place of employment which are free from recognized hazards.⁸³ Under federal construction contracts, contractors are responsible for complying with all federal, state, and municipal laws applicable to the performance of the work. The contractor is also responsible to take proper safety and health precautions to protect the work, the workers, the public, and the property of others.⁸⁴

The Secretary of Labor has issued safety standards that govern the construction industry (29 CFR 1926, and 29 CFR 1910).⁸⁵ The accident prevention clause of federal construction contracts incorporates the above OSHA regulations by reference into the construction contract. The clause also requires that contractors working on Department of Defense construction contracts comply with the U.S. Army Corp of Engineers Safety and Health Requirements Manual, EM 385-1-1. The EM 385-1-1 is a comprehensive manual and a good practical portable reference source to be used by the government inspector in verifying a contractor's compliance with appropriate safety measures.

The EM 385-1-1 lists several general requirements that are worth mentioning:

- 1) An acceptable accident prevention plan written by the prime contractor for the specific work and implementing in detail the pertinent requirements of this manual, will be reviewed by

designated government personnel.⁸⁶

2) The accident prevention plan shall provide for frequent and regular safety inspections of the work sites, materials, and equipment by competent persons.⁸⁷

3) An activity hazard analysis shall be prepared by the contractor for each phase of work. The analysis will address the hazards for each activity performed in that phase and will present the procedures and safeguards necessary to eliminate the hazards or reduce the risk to an acceptable level.⁸⁸

4) Each employee shall be provided initial indoctrination and such continued safety training to enable them to perform their work in a safe manner.⁸⁹

5) At least one safety meeting shall be conducted weekly by field supervisors or foremen for all workers.⁹⁰

Enforcement of the requirements of the EM 385-1-1 will force contractors to plan and think about the safety aspects of the work. An awareness and emphasis of safety will lead to a safer job site.

Job site safety in and of itself is not an item that is recognizable in the finished construction project. Accident costs in construction are estimated at 6.5 percent of total construction costs.⁹¹ Accident costs will be passed on to the owner in the form of higher costs on future projects. A survey of a large number of contractors revealed that approximately 2.5 percent of direct labor costs was required to administer a construction safety and health program.⁹² The contractors that were part of the survey had recordable injury rates of only 36 percent of the average rate of

the construction industry as published by the National Safety Council (NSC). These same contractors had an OSHA lost workday rate of only 2.7 percent of the average rate published by the NSC. A study of owners in regards to safety of construction projects was conducted by Stanford University.⁹³ Owners with better than average construction safety records:

- 1) Require contractors to obtain work permits for specific activities (ie open flame burning, confined space entry).
- 2) Consider contractor's safety record in awarding a negotiated contract.
- 3) Conduct formal site inspections.
- 4) Use some form of goal setting for contractors to reduce accidents.
- 5) Keep statistics separately by contractor.
- 6) Have construction safety department to monitor and confer with contractor on job site safety.
- 7) Stress safety as necessary part of job.
- 8) Are involved in training sessions for construction site supervisors and workers.

In order for a contractor's safety program to work, it must have commitment from top management. Government contracts make safety part of the contract requirement, and thus all contractors should anticipate providing a safe work environment and allow for that in formulating their bid. Safety is part of the contract, and as such should be enforced by the government inspector not only for the contractor's workers benefit but in fairness to all other

bidders.

The government inspector or contract administrator has the right to stop the work of a contractor that is not complying with the appropriate safety standards. Only the work that is deemed to be unsafe should be stopped otherwise the contractor may have a cause to claim that the project is being delayed unjustly by the government.

11.2 Specialized Work: Asbestos Example

Some types of work such as asbestos removal require special training and licenses granted by a government agency. Maryland requires all contractors performing asbestos removal to provide a minimum amount of training to their employees and be licensed to perform asbestos removal. Licensing is no guarantee that a contractor will operate in a safe manner. An asbestos removal license can be obtained in Maryland by submitting a nominal fee (less than \$ 300) and showing that the employees have had training in the hazards involved in asbestos removal. Asbestos removal is a specialized operation and very few owners have the expertise to inspect the contractor's work to insure compliance with OSHA safety regulations. Many government agencies concerned with the risks of exposure to asbestos have provided large amounts of money to be used for asbestos removal contracts. Entering the asbestos removal business does not require large amounts of capital. The author has seen the number of companies in the asbestos removal business grow very rapidly in the past few years as indicated by the increasing number of contractors that bid upon asbestos removal work. As a

result of the large number of contractors and the relative ease of entering the asbestos business, the author has witnessed wide variations in the quality of work performed by asbestos removal contractors. State officials who regulate the asbestos removal business are few and far between. The best way an owner can ensure a safe job site in regards to asbestos removal is to become educated as to the specific requirements or retain a representative who is familiar with the requirements. The owner will also directly benefit by maintaining a safe job site with a decrease in liability that is associated with asbestos removal projects.

CHAPTER 12: CLAIMS AND REMEDIES

12.1 Contract Disputes Act

A claim in the context of government contracting means a written demand or written assertion by one of the contracting parties seeking as a matter of right, the payment in a sum certain, the adjustment or interpretation of contract terms, or other relief arising under or relating to the contract.⁹⁴

The Contract Disputes Act of 1978 (41 USC 601-603) sets forth procedures for asserting and resolving claims by or against contractors. The act also states that a contractor must certify any claim in excess of \$ 50,000.⁹⁴ The certification states that the claim is made in good faith, that supporting data are accurate and complete to the best of the contractor's knowledge and belief, and the amount requested accurately reflects the contract adjustment for which the contractor believes the government is liable. The act also provides for a civil penalty for any claims that are found to be fraudulent or based on a misrepresentation of fact.

12.2 Disputes Clause ⁹⁶

Federal contracts contain a disputes clause which explains the procedures to be followed by the contractor in settling a contract dispute. All disputes are to be settled by using the procedures of this clause.

Any claim by the contractor is to be made in writing and submitted to the contracting officer for a written decision. The contracting officer must issue a written decision within 60 days

for any claim under \$ 50,000, and either issue a decision or inform the contractor of a date by which a decision will be made for any claim over \$ 50,000. The contractor is bound by the contracting officer's decision unless he appeals. The contractor is also required to proceed with the performance of the contract while awaiting a contracting officer's decision.

12.3 Appealing a Contracting Officer's Decision

The contractor can appeal the contracting officer's decision to the government agency's board of contract appeals (BCA). In the case of the Department of Defense it would be the Armed Services Board of Contract Appeals (ASBCA). An appeal to an agency BCA must be made within 90 days from the date a contractor receives a written contracting officer's decision.

Alternatively, the contractor can appeal the contracting officer's decision to the U. S. Claims Court. This appeal must be made within one year of receiving a contracting officer's decision. The BCA and U. S. Claims Court decisions may be appealed to the U. S. Court of Appeals for the Federal Circuit. (60 days for Claims Court appeal and 120 days for BCA appeal). A flow chart of the disputes process for Department of Defense contracts is presented in appendix D.

12.4 Cause of Disputes

Below is a list of some of the frequent causes of contract disputes:

- 1) Differing site conditions.
- 2) Delay in approving contractor submittals.

- 3) Disagreement in specification requirement (level of effort required, quality, etc.).
- 4) Disagreement over price of modification.
- 5) Owner delay of job.
- 6) Rejection of work.

Dealing with a dispute over differences in contract interpretations is perhaps the easiest. Many disputes are rooted in an unharmonious relationship between the contractor and owner. The latter types of disputes tend to become emotional with each party feeling a need to defend its actions. The dispute becomes a matter of one party's actions or lack of action rather than a focus on the contract language.

12.5 Alternative Disputes Resolution

Using the contract disputes procedure may require a large amount of time before the case is heard and a significant amount of money in legal fees for the contractor. In the private sector arbitration* has long been recognized as an alternative disputes resolution and is specified in article 7.9 of the American Institute of Architect's general conditions of the contract for construction.

Arbitration is not used in federal contracts. The Contract Disputes Act requires contracting officers to issue a decision and provides a procedure to appeal the contracting officer's decision as discussed above.

Mediation is also used in the private sector. Mediation differs from arbitration in that both parties retain the power to

make decisions. The mediator acts as a neutral third party to help each party understand the other party's stand on the issues.

A new form of mediation called a minitrial is being used in some federal contracts. In a minitrial, a short hearing is conducted (about a day) in which a representative from both sides presents evidence in support of his position concerning the claim. It is sometimes better to have parties that were not involved in the claim present the argument for their side as some claims become emotional battles. The mediator helps each party articulate his position and understand the other's position.

In any type of litigation there is a risk of losing. The minitrial is designed to present the views of each side in a manner that an equitable settlement can be reached without having to endure the risk of losing in court.

12.5a ADR Example⁹⁷

The Bureau of Reclamation recently settled a claim for \$55.8 million using the alternative disputes resolution. This is the largest claim settlement ever reached by the Department of Interior under an ADR method. The project was a \$44.8 million contract to build a flood control project on the Pecos river near Carlsbad, New Mexico. Both sides were swayed by what was expected to be an 8 week court hearing and a possible 3 year wait for final resolution.

The contract did not contain provisions for alternative claim resolution. The case was scheduled to be heard before the Department of Interior's board of contract appeals. The board contacted both sides and asked if they would consider ADR. The ADR

allowed for a speedy solution to the problem.

12.6 Remedies of the Government

Throughout this paper various aspects of the contracting process have been discussed and examples have been cited to show how some contractors and owners violate the contract and in some cases by fraudulent behavior, the law. The government has legal rights that can be pursued in regards to contract violations and illegal actions. Some of these rights and remedies of the government were discussed in chapters dealing with specific subjects (material and workmanship (chapter 5), truth in negotiations (chapter 6), payment practices (chapter 7), contract safety (chapter 11)).

12.6a False, Fictitious, or Fraudulent Claims Act (18 USC 287)

The False, Fictitious, or Fraudulent Act makes it illegal to make any false, fictitious, or fraudulent claim against any agency or department of the United States.⁹⁸ The crime is committed when the claim is presented. Payment of the claim is not an element in determining if a crime has been committed. Violators of the act can be fined up to one million dollars and imprisoned up to five years.

12.6b False Claims Act (31 USC 3729)

Under the False Claims Act a civil penalty of \$5,000 - \$ 10,000 plus three times the amount of damages sustained by the government may be invoked for contractors that knowingly submit a false claim to the government for payment. The difference in the two acts is that the False Claims Act provides civil penalties less severe than

the criminal penalties of the False, Fictitious, or Fraudulent Claims Act.

The False Claims Act defines when a false claim is submitted knowingly:

- 1) If a person has actual knowledge that it is false or,
- 2) Acts in deliberate ignorance of whether it is true or false or,
- 3) Acts in reckless disregard of its truth or falsity.

A contractor can be charged under both the criminal and civil statutes. For prosecution under the criminal false claims statute, the offender must have actual knowledge.

The Contract Disputes Act of 1978 (P L 95-563) states that if a contractor cannot support any part of his claim and it is determined that the inability is due to misrepresentation of fact or fraud on the contractor's part, he will be liable to the government for an amount equal to such unsupported part of his claim and also for the government's cost of reviewing his claim. The act also states that the agency contracting officer does not have the authority to settle claims involving fraud.

12.6c False Statements

The False Statements Act, 18 USC 1001, makes it illegal to

:⁹⁹

- 1) Falsify, conceal, or cover up a material fact by trick, scheme or device.
- 2) Make false, fictitious, or fraudulent statements or representations.

3) Make or use any false document or writing.

An example of a violation would include a contractor falsifying an inspection report. A false statement can be oral or written. Violators of the act can be fined up to \$10,000 and imprisoned for up to five years.

12.6d Mail Fraud

The Mail Fraud Act, 18 USC 1341 makes it illegal to engage in any scheme to defraud in which the mail is used. Examples include using the mail to submit a false claim or statement.

12.6e Program Civil Remedies Act (31 USC 3801)

The Department of Justice does not have the time and/or resources to prosecute every case of fraud. The DOJ usually only pursues those cases that involve large sums of money or have a deterrent value. This act establishes administrative procedures for resolving allegations of false claims for amounts less than \$ 150,000. These procedures require an investigation by an official in the Office of the Inspector General for the agency.¹⁰⁰ The report made by the official is sent to a high level reviewing official of the agency. If there is sufficient evidence to believe that the contractor is liable, the reviewing official submits a written summary to the attorney general. The attorney general must approve or disapprove the written decision within 90 days. Upon approval, the matter is referred to a presiding officer for discovery, in which each party obtains evidence from the other, and a hearing. After the hearing, the presiding officer issues a

decision which includes findings of fact and conclusions of law. The decision is final unless the contractor appeals to the agency head within 30 days.

For each false claim that the government has paid, the contractor is liable to reimburse the government up to twice the claim plus a \$ 5,000 civil penalty.

12.6f Bribery of Public Officials (18 USC 201)¹⁰¹

Whoever, directly or indirectly, corruptly gives, offers or promises anything of value to any public official or person who has been selected to be a public official, or offers or promises any public official, or any person who has been selected to be a public official to give anything of value to any other person or entity, with intent:

- 1) To influence any official act or,
- 2) To influence such public official or person who has been selected to be a public official to commit or collude in, or allow, any fraud, or make opportunity for the commission of any fraud, on the United States; or,
- 3) To induce such public official or such person who has been selected to be a public official to do or omit to do any act in violation of his lawful duty...

shall be fined not more than \$ 20,000 or three times the monetary equivalent of the thing of value, whichever is greater, or imprisoned for not more than fifteen years, or both, and may be disqualified from holding any office of honor, trust, or profit

under the United States. The penalties under this statute also apply to the person who accepts the bribe.

12.6g Anti Kickback Act of 1986

The Anti Kickback Act was discussed in chapter 4. Violators of this act are subject to civil penalties of twice the kickback plus \$10,000 for each occurrence and up to ten years in prison. Additionally, contracting officers can deduct from the contractor's payment any amount used to pay kickbacks.

12.7 Intent to Commit Fraud

The application of any of the penalties is a legal process. The above discussion was provided to help understand the penalties of committing fraud under a government contract and not meant to be a comprehensive step by step guide of actions to be taken by a contracting officer. Contracting agencies have legal counsel available for the contracting officer to consult for legal guidance. In many cases, a contractor's claim may contain errors. This is not automatically an indicator of fraud. A key in prosecuting a contractor under the above mentioned statutes is in many cases proving that the contractor willingly and knowingly intended to deceive the government. The above mentioned statutes help to maintain public confidence in the government procurement process.

12.8 Debarment

Debarment is an action the government can take to ensure that government contracts are awarded only to responsible contractors. The following are reasons for debarment:¹⁰²

- 1) Commission of fraud or a criminal offense in connection with obtaining, attempting to obtain, or performing a public contract or subcontract.
- 2) Violation of Federal or State antitrust statutes relating to the submission of offers.
- 3) Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, or receiving stolen property.
- 4) Commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a government contractor or subcontractor.
- 5) Willful failure to perform in accordance with the terms of one or more contracts
- 6) A history of failure to perform, or of unsatisfactory performance of, one or more contracts.
- 7) Violations of the Drug-Free-Workplace Act of 1988 (Public Law 100-690)

The period of debarment generally does not exceed three years and depends upon the seriousness of the violation. Violation of the Drug-Free-Workplace Act may result in debarment for up to five years.¹⁰³

12.9 Ineligibility

Some statutes specify that any contractor that violates its provisions will be ineligible for future contracts. Violations of the Davis Bacon Act and the Buy American Act will result in a

contractor being ineligible for future contracts.

12.10 Prevention of Claims

One way to significantly reduce false and fraudulent claims is to prevent a claim from occurring. Contract administrators do not have total control over whether or not a dispute develops on a particular contract, but can reduce the chances of a claim by practicing proactive contract administration.

All obstructions to a contractor's progress must be removed. This is a general statement but encompasses a wide area. Government inspection personnel must not overinspect a contractor's work or cause excessive delays during inspection. Approval for a contractor's submittals should be granted or denied in a reasonable period of time (three weeks is considered reasonable for most submittals unless they are of an extremely complicated nature).

The government will have to pay for any of the contractor's delays that are not self imposed or excusable under the defaults clause of the contract (FAR 52.249-10). Proactive contract administration means closely monitoring situations in which a delay or dispute may occur and working to prevent the occurrence.

If a dispute is inevitable, proper documentation of the facts during the delay period or dispute should be recorded. The nature of the work and extent affected should be documented. Contemporaneous records of delay will be more accurate and carry more weight than allegations of its effect put together many months after the delay or dispute occurred.

The contract administrator should try to settle a dispute

based on the facts as recorded and their effect on the contractor. By being objective, the contract administrator can try to negotiate a settlement before a dispute turns into a claim.

CHAPTER 13: CONCLUSION

This paper has looked at a number of fraudulent practices that can occur at various stages during the construction process. If both contracting parties (owner and contractor including subcontractors) are aware of the expectations of fairness placed upon them and the consequences for violating the rules, then the opportunity for fraud to occur can be greatly reduced.

13.1 Getting Started with the Right Attitude

Federal contracting officers are required to have a meeting with the contractor before construction commences (usually termed preconstruction conference) to inform the contractor concerning the labor standards clauses of the contract.¹⁰⁴ The preconstruction conference is a good time to discuss the "ground rules" that the contractor must follow while performing the contract. The author has prepared a standard agenda of items to be discussed at preconstruction conferences based upon three years of experience in administering construction contracts at the United States Naval Academy. The preconstruction agenda is presented in appendix E. Most of the "ground rules" are spelled out in the text of the contract in the general requirements or are requirements that are incorporated by reference. The author's experience indicates that a substantial number of contractors do not read or understand their contract obligations. The preconstruction conference lasts between one and one and a half hours and serves the sole purpose of acquainting the contractor with the government requirements and procedures. The conference is not a technical question and answer

session as this could turn into a long and controversial meeting.

13.2 Equal Treatment for all Contractors

A contract administrator or inspector after reading about the types of fraud discussed in this paper should be able to recognize the indicators of such activity and understand the appropriate action to take.

The integrity of the contracting system must be protected. To assure this, all contractors must be treated equally and fairly, and the rules must be enforced uniformly for all. A system that favors one contractor over another will discourage honest contractors from bidding. The terms of the contract should be fair. Some owners write contracts that place all of the risk for an unknown condition on the contractor. These types of contracts will encourage a contractor to cut costs if he encounters an unforeseen site condition which increases his cost and for which he knows he will not be compensated. These unfair contracts also tend to discourage contractors from bidding and limit competition.

13.3 Guidelines for Contract Administration

During the author's three years at the United States Naval Academy, several courses of action were noted to contribute to quality construction with a minimum of problems:

1) Maintaining a professional relationship with the contractor

This means treating the contractor fairly and being consistent in administering policy (even if the contractor is not well liked or is performing poorly). Being consistent and fair will earn the respect of the contractor. The contractor may not agree with all

decisions but he will know what to expect and what course of action to pursue in regards to the decision. A professional relationship also means that the government standards of conduct are followed at all times in any relationship with a contractor.

2) Familiarity with requirements of project and terms of contract

There is no substitute for knowing the requirements of the contract and the provisions of the contract that give the contract administrator the authority to enforce the contract.

3) Inspection of work

Frequent appearances on the jobsite, but at unpredictable times, will convey to the contractor that there is a great likelihood that he will be caught if the work does not conform to the requirements of the contract and that the risk will not be worth taking.

4) Conveying to the contractor an attitude that quality work in accordance with the specifications is expected and nothing short of that will be accepted.

This does not mean to constantly be on the contractor's back or overinspecting the work and interfering with the contractor's progress. A contract administrator should hold the contractor to the terms of the contract. This is an important responsibility of the contract administrator as it maintains the integrity of the contracting system. All contractors must be expected to perform to the same standards, anything less would not be fair to the contractors that did not win the bid. These contractors could

argue that they would have been the low bidder had they been allowed to perform at a standard less than that specified.

13.4 Integrity of Federal Construction Contracting System

Government contracting is different from private sector contracting in that many social goals are promoted through contracting. The enforcement of these social goals requires additional effort from the contract administrator but is also important in maintaining the integrity of the contracting system. It is important that when the contractor or contract administrator is found to have violated the rules or law in regards to a contract action that appropriate action be taken. A contracting system that does not take corrective measures will be viewed by the public as wasteful and corrupt. Contractors will be discouraged from bidding in such a system for fear that they will not be treated fairly. A lack of bidders will increase the price of the work. The types of contractors that bid will probably contribute to further contracting problems.

The author believes that the federal construction contracting system is fair to contractors and provides construction for the federal government in an efficient manner that is free from bias and corruption. The federal construction contracting procurement system is open to the public and subject to review at all stages with very limited exceptions (typically in matters of national security). This openness in itself prevents many forms of contract fraud. It is true that isolated incidences of corruption and fraud do exist. This is not a sign of weakness or of a failure of the

contracting system. There are laws and regulations that prescribe actions to be taken when violations occur. In many instances, contract fraud is viewed as a white collar crime and probation or lenient sentences are handed out to violators that are caught and convicted. Judges need to hand out more stringent sentences to discourage contractors and procurement personnel from participating in illegal activities.

By recognizing the signs of fraud and following the recommendations discussed in this paper, contract administrators and inspection personnel can create an atmosphere of trust between the government and contractor. This will lead to a quality job that is built safely.

APPENDICES

- Appendix A: Cost Modification Form
- Appendix B: Standards of Conduct
- Appendix C: Daily Report Form
- Appendix D: Flow Chart for Appeals
- Appendix E: Preconstruction Meeting Agenda
- Appendix F: Glossary

Appendix A
Cost Modification Form

PROPOSAL/ESTIMATE FOR CONTRACT MODIFICATION

DATE:

NAVFAC 4330/43 (8/88)

CONTRACT TITLE:

CONTRACT NO:

ROICC OFFICE:

DESCRIPTION:

PRIME CONTRACTOR'S WORK				Revisions/Comments
1. Direct Materials				
2. Sales Tax on Materials	% of line 1	%		
3. Direct Labor				
4. Insurance, Taxes, and Fringe Benefits	% of line 3	%		
5. Rental Equipment				
6. Sales Tax on Rental Equipment	% of line 5	%		
7. Equipment Ownership and Operating Expenses				
8. SUBTOTAL (add lines 1 - 7)				
9. Field Overhead	10.00% of line 8	%		
10. SUBTOTAL (Add Lines 8 & 9)				
Prime Remarks:				

SUB-CONTRACTOR'S WORK				Revisions/Comments
11. Direct Materials				
12. Sales Tax on Materials	% of line 11	%		
13. Direct Labor				
14. Insurance, Taxes, and Fringe Benefits	% of line 13	%		
15. Rental Equipment				
16. Sales Tax on Rental Equipment	% of line 15	%		
17. Equipment Ownership and Operating Expenses				
18. SUBTOTAL (add lines 11 - 17)				
19. Field Overhead	10.00% of line 18	%		
20. SUBTOTAL (add lines 18 & 19)				
21. Home Office Overhead	3.00% of line 20	%		
22. Profit	% of line 20	%		
23. SUBTOTAL (Add Lines 20 - 22)				
Sub's Remarks:				

SUMMARY				Revisions/Comments
24. Prime Contractor's Work (from line 10)				
25. Sub-contractor's Work (from line 23)				
26. SUBTOTAL (add lines 24 & 25)				
27. Prime Overhead on sub-contractor	5.00% of line 25	%		
28. Prime's Home Office Overhead	3.00% of line 24	%		
29. Prime's Profit	% of line 26	%		
30. SUBTOTAL (add lines 26 - 29)				
31. Prime Contractor's Bond Premium	% of line 30	%		
32. TOTAL COST (Add Lines 30 & 32)				
Estimated time extension and justification				

Prime Contractor name:

Sub-contractor name:

Signature & Title of Preparer:

Date:

Contract Modification Proposals shall be addressed to the Resident Officer in Charge of Construction. Proposals must clearly state conditions and scope of the modification and shall be accompanied by a breakdown of cost, as indicated. Lump sum costs will not be accepted in either the prime or sub-contractor's breakdown of direct cost. The total cost for labor, material, and equipment rental (ownership) for each item shall be transferred to the corresponding item on the front of this form. At the contractor's option, the head rates printed on the front of this form may be used for proposals under \$ 500,000 in lieu of detailed itemized estimates of head costs. The proposal should also include a request for an extension of time, in calendar days, only if overall completion of project is impacted by the proposed modification. The contractor shall not proceed with any of the work included in the modification prior to receipt of an executed modification of contract (SF30).

Contract No. _____

Date: _____

ITEMS OF WORK FOR Prime Contractor	QTY	UNIT	MATERIAL		LABOR		R O	EQUIPMENT		
			Unit Cost	Total Cost	Unit Cost	Total Cost		Days	Rate	Total
DIRECT Prime Contractor's TOTALS							R	Total (Rental)		
							O	Total (Owned)		

[illegible]

Appendix B
Standards of Conduct

STANDARDS OF CONDUCT FOR DEFENSE DEPARTMENT PERSONNEL

DON'T	do business for the Government with firms in which you or any of the following have an interest; your spouse; your minor child; your partner; any organization in which you serve as officer, director, trustee, partner or employee; or any person or organization with whom you are negotiating or have an arrangement concerning prospective employment.	DON'T	use your military or civilian title in connection with a commercial enterprise while on active duty.
DON'T	use your position or information gained through your position for financial benefit of yourself, your family, or for persons with whom you have financial ties.	DON'T	conduct Government business outside of official business hours, on other than official telephones, or at other than official places of duty.
DON'T	accept - from DOD Contractors or those seeking to become contractors - gifts, meals, drinks, favors or other gratuities, including benefits, discounts, tickets, passes, transportation, accommodations or hospitality and don't permit any to be given or extended in your behalf.	DON'T	permit members of your family to do what you should not do.
DON'T	make personal purchases from contractors except through regular retail outlets at regular prices.	DON'T	after leaving the Government, represent anyone other than the United States in connection with a matter in which the United States is a party or has an interest and in which you participated personally and substantially for the Government.
DON'T	release information in advance.	DON'T	for one year after your Government employment, appear personally in order to represent anyone other than the United States in connection with a matter in which the United States is a party or has an interest and which was within the boundaries of your official responsibility during the last year of your Government service.
DON'T	assist others for compensation in transactions with the Government.	DO	conduct yourself so as to be above reproach or suspicion.
DON'T	assist others as attorney or agent in transactions with the Government, regardless of whether you are paid.	DO	maintain a reputation for courtesy, fairness, integrity and strict impartiality.
DON'T	commit the Government by unauthorized statements.	DO	treat all persons according to their merits, without regard to race, religion, color, sex, or place of origin.
DON'T	make gifts to supervisors or their families and don't accept gifts from subordinates.	DO	refrain from outside activities which interfere with or give the appearance of interfering with your duties.
DON'T	falsify any writing or document.	DO	avoid lunching or dining with contractors.
DON'T	remove or destroy a Government record.	DO	pay all valid debts and maintain a good reputation in the community.
DON'T	accept pay from others for the same service for which you are paid by the Government.	DO	report in writing directly to the Commander all gifts or offers of gifts made by contractors or representatives and any evidence of, or information relative to, corruption or improper conduct.
DON'T	accept anything of value in return for being influenced in the performance of your official duties.	DO	report immediately in writing all telephone calls received on other than official telephones at official places of duty or visits made after business hours.
DON'T	engage in gambling with contractors or let them place a bet in your behalf.	DO	assure yourself that representatives of firms are properly identified.
DON'T	deal with unauthorized individuals.	DO	consult your superior if in doubt.

Appendix C
Daily Report Form

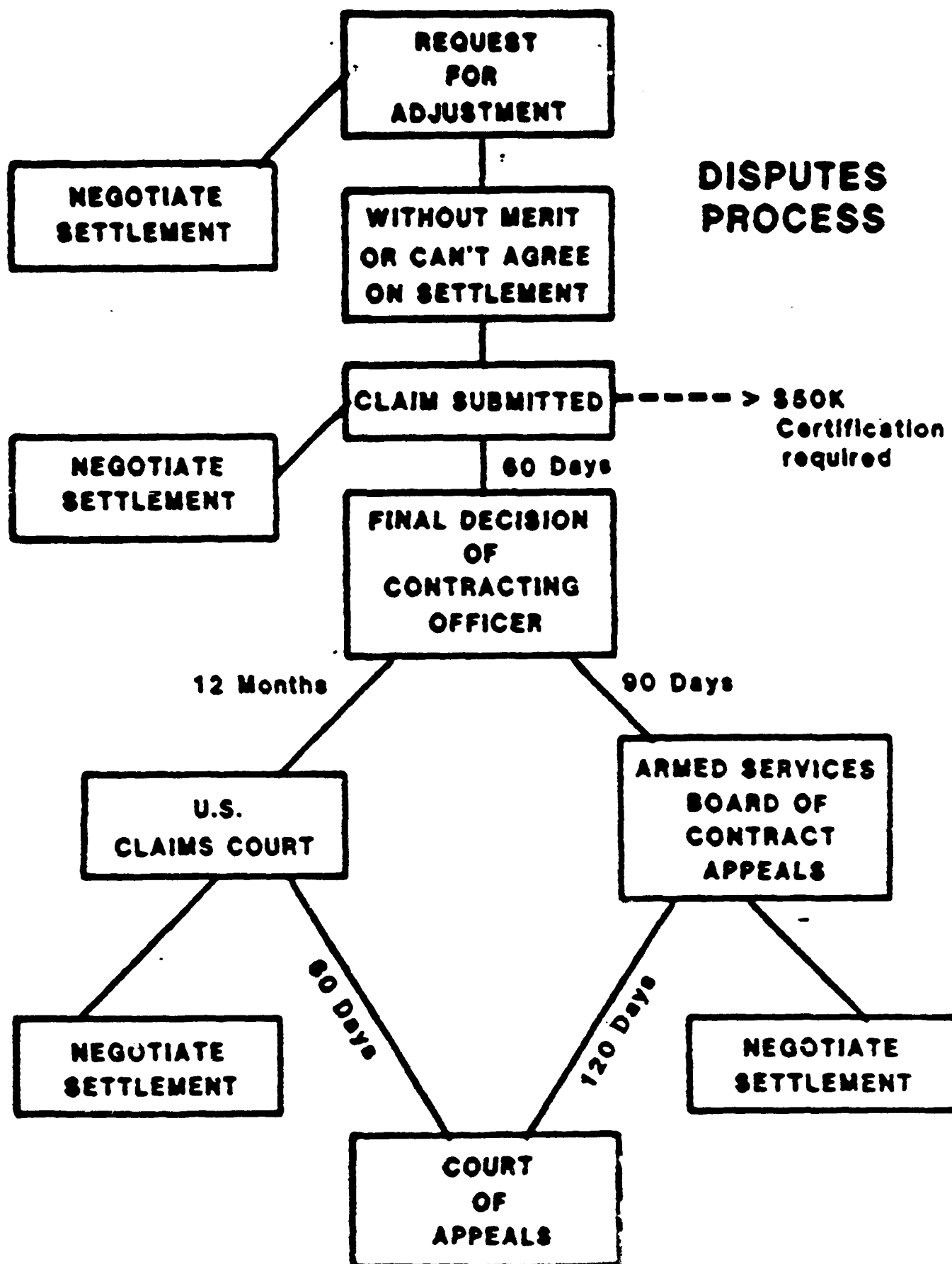
DATE:

IF "YES", A COPY OF THE COMPLETED OSHA REPORT IS REQUIRED

15. *Chen, H. and Chen, H. (2004)*

SPEC. PARA. AND/OR DRAWING NO.	LOCATION AND DESCRIPTION OF DEFICIENCIES <i>(Materials, Equipment, Safety, and/or Workmanship)</i> ACTION TAKEN OR TO BE TAKEN		
DEFICIENCIES CORRECTED THIS DATE		REFERENCE	
		REPORT NO.	COMPLIANCE NOTICE NO.
INSPECTION AND/OR TESTING PERFORMED TODAY-FOLLOW WITH REPORT	LOCATION AND/OR ELEMENT OF WORK	REMARKS RESULTS OF INSPECTION/TESTING	
SPEC. PARA. AND/OR DRAWING NO.	EQUIPMENT/MATERIAL RECEIVED TODAY TO BE INCORPORATED IN JOB <i>(Description, Sizes, Quantity)</i>	SUBMITTAL NO. OR CERTIFICATION	DATE APPROVED
REMARKS <i>(Include directions received from ROICC/AROICC, visitors, compliance notices received, errors and/or omission in P/S; pertinent information)</i>			
CONTRACTOR/SUPERINTENDENT		DATE	
CONSTRUCTION REPRESENTATIVE'S REMARKS AND/OR EXCEPTIONS TO THIS REPORT			
CONSTRUCTION REPRESENTATIVE		DATE	

Appendix D
Flow Chart for Appeals

**DISPUTES
PROCESS**

Appendix E
Preconstruction Meeting Agenda

RECORD OF PRECONSTRUCTION CONFERENCE

Subj: Contract #

1. At _____, a preconstruction conference was held in the office of the Officer in Charge/Resident Officer in Charge of Construction for the purpose of discussing preconstruction details with the contractor. Present at this meeting were:

Contractor Personnel _____ Government Personnel _____

2. Administrative matters

a) Contract number _____, (_____)
was awarded on _____ for \$ _____ with a completion date of _____
and liquidated damages of \$ _____ per day.

b) The contractor's address and telephone number after hours in an emergency are:

- c) The contractor will provide a listing of key personnel for prime and subcontractors with telephone numbers.
- d) An explanation of the ROICC organization and procedures was made, i.e., the Officer in Charge of Construction/Resident Officer in Charge of Construction is solely responsible for authorizing changes in the contract plans and specifications and for administering the contract through his authorized representatives. It was explained to the contractor that the inspector has all of the authority necessary to see that the work is completed within the requirements of the plans and specifications but has no authority concerning change order matters affecting time and price or contractor's methods or procedures as long as they conform to the plans and specifications and to safe construction practices.
- e) The contractor's superintendent shall be on the job site at all times and have the authority to act for the contractor.
(FAR 52.236-6)
- f) Base parking passes can be obtained at the pass and tag office near gate three. Be prepared to present vehicle registration, proof of insurance, social security number, date of birth, etc.
- g) The base number in case of any emergency is 267-3333 or 3333 from any base phone.
- h) Any correspondence shall reference the contract number.

3. Preconstruction requirements

- a) Insurance certificates shall be submitted to ROICC for prime and subcontractors. Types and amounts of insurance and wording of cancellation clause shall be as described in general paragraphs of specification, paragraph 1.5. No work shall be preformed until insurance certificates are received.
- b) Schedule of prices shall be submitted. (NAVFAC form 4330/4) no payment will be processed until it is received. (sample enclosed)
- c) Contractors schedule of work shall be submitted. No payment will be processed until it is received. (FAR 52.236-15)
- d) Payment and performance bonds shall be approved before any work starts.
- e) The contractor expects to start work on _____.
- f) The contractor's normal work hours shall be _____.

Work outside of normal contract work hours requires advance notification of the ROICC office. (General paragraphs, paragraph 2.1.2)

h) The contractor shall provide advance notice of utility outages, obstructions to traffic, and any operations which impact on the customers or the public.

i) Location of a field trailer and storage shall be as indicated on the plans and specifications or as arranged by the Contracting Officer. (Additional General Paragraphs, paragraph 2.1.2, FAR 52.236-10)

4. Safety (FAR 52.236-13)

a) Army Corp of Engineer's Manual EM-385-1-1 APR87
Manual can be obtained from: Superintendent of Documents
US Government Printing Office
Washington DC 20402
(202) 783-3238

b) EM-385-1-1 section 1 (Instruction and Training) requires the contractor to submit a job specific accident prevention plan. Appendix y offers help in preparing the plan.

c) Hot permits are required for any cutting/welding and are issued by the fire department, 267-3331 or 3331 from any base phone.

d) Any accidents shall be reported on OSHA form 101.

e) Some common safety violations:

1) Improper personnel protective equipment,
minimum short sleeve shirt, long pants, and work shoes.

2) Not using safety glasses during cutting and grinding.

3) Improper use of ladder or scaffolding.

4) Frayed and Worn extension cords.

5) Failure to wear safety harness when working at heights.

6) Refer to enclosed check list for other precautions.

f) Job site clean up shall be performed daily. (FAR 52.236-12)

g) Hazardous Material Identification And Material Safety Data.
(FAR 52.223-3)

5. Construction schedule

a) Schedule shall be submitted by contractor prior to starting work.

b) Updated copy must be submitted with each invoice and when required by major changes in the work, or progress payments will be withheld. (FAR 52.236-15)

c) Progress schedule should be annotated to the various classes of work broken down into:

- 1) Time projected for submittals, approval and procurement.
- 2) Time for installation and erection.
- 3) Time for testing and inspection.

6. Payment (FAR 52.232-5, DFAR 52.232-7005)

a) Invoice for payment shall be submitted on NAVFAC invoice forms provided to the contractor .

b) Contractor superintendent and construction representative will agree on work in place and material on site before invoice is submitted.

c) Payment shall be made only for satisfactory work.

d) No payment will be processed without a schedule of prices.

- 1) Submit on NAVFAC 4330/4.
- 2) Use only work items. (spread mobilization over other items ,unless exceptionally high)
- 3) If mobilization is allowed, then demobilization must also be included on schedule of prices.
- 4) Work items must be broken down into material and labor components.

e) Payrolls must be current and certified or payment will not be processed.

f) Payment for stored materials shall be in accordance with contract specifications. If stored materials are to be billed, then a separated sheet must be attached listing the material that is stored at the work site. The contractor shall also provide receipts for the material. An amount not to exceed 85% will be paid for stored materials provided that the above requirements are met and that the materials are adequately protected.

g) Final release must be submitted before final payment can be processed.

h) A retention of 0-10% will be withheld depending on satisfactory performance.

1) If a retention is withheld, the next invoice shall indicate on line D of the Contractor's Invoice form the amount billed for to date in the last invoice not the amount that has been paid to the contractor to date.

2) The retention shall be released upon satisfactory completion of the work or at the end of the contract performance period provided that there are no liquidated damages.

7. Labor Standards Provisions

a) To be followed by contractor at all times during performance of contract.

b) 11 provisions are included in text in contract.

8. Submittals (General paragraphs, section 01010, paragraph 1.9)

a) All submittals shall refer to the specification section and paragraph to which it pertains.

b) Samples are also to be accompanied by complete information. General Requirements sections usually list the detail required in a submittal i.e. mechanical general requirements section 15011, and electrical general requirements section 16011.

c) Submit number of copies as indicated in specifications or requested by Contracting Officer.

d) Contractor to certify that submittals conform to contract requirements and can be installed in the allocated spaces.

e) Any deviations shall be noted and submitted in writing for ROICC approval.

f) Incomplete submittals shall be returned without processing.

g) Time for submittal approval shall be allowed in the construction schedule (three weeks in most cases will be sufficient, longer times may be necessary for more complex items).

h) All material shall be new unless specified otherwise (FAR 52.236-5).

i) Only domestic construction material will be used for contract (FAR 52.225-5).

9. Reporting requirements

a) Contractor Daily reports by 10 am following day (specification section 01010 paragraph 1.10).

b) Payrolls.

1) Submit weekly in accordance with wage decision included in contract documents.

2) Must be accompanied by statement of compliance.

3) Wage interviews will be conducted on contractor employees.

4) Progress payments will not be processed if contractor falls behind in submitting payrolls.

5) Final payment will not be made until all payrolls are received.

10. Modifications

a) Cost estimates shall be submitted on NAVFAC form 4330/43. (enclosed with request for proposal)

b) Contractor shall breakdown costs of work (also includes subcontractors) DFARS 52.236-7001.

c) Time extensions for material delays shall be in accordance with FAR 52.249-10. (DPAS manual)

d) Unforeseen conditions. (FAR 52.236-2)
contractor shall immediately notify the Contracting Officer in writing before conditions are disturbed of how conditions differ materially from those indicated in the contract.

11. Contract closeout

a) All daily reports and payrolls are current.

b) All manuals are submitted.

c) Punchlist complete.

d) Final invoice and release.

12. Contractor evaluation

a) A contractor's performance evaluation will be filled out by the ROICC office upon the completion of this contract.

b) The following elements will be evaluated:

- 1) Quality of work.
- 2) Timely performance.
- 3) Effectiveness of management.
- 4) Compliance with labor standards.
- 5) Compliance with safety standards.

13. Additional Items

- a) The following concerns were discussed:

Sincerely,

J E Gentry
By Direction of the Resident
Officer in Charge of Construction

Appendix F

Glossary

GLOSSARY

Agency head - The Secretary (or Attorney General, Administrator, Governor, Chairperson, or other chief official, as appropriate) of the government agency.

Allowable costs - Costs that a contractor incurs in the performance of a project or running his company that may be passed on to the government. Some costs such as entertainment are not allowable

ANSI - American National Standards Institute, an organization that sets performance standards for various materials and products.

Arbitration - A dispute resolution process in which a neutral third party listens to the case of each party involved in the dispute and decides how to resolve the dispute.

ASTM - American society for testing and materials, an organization that sets standard test procedures to be followed for testing materials.

Base contract - The basic form of the contract that is awarded to the contractor, the original contract not including modifications.

Contracting agency - A part of the government that has the authority to enter into contracts

Contract clauses - Clauses that state the rights of one or both of the contracting parties (government and contractor) in regards to a particular area. I.E. differing sites condition clause, Inspection clause.

Contraction officer - The government official that has the authority to enter into, administer, and/or terminate contracts and make related determinations and findings.

Contracting officer's decision - A determination made by the contracting that expresses the governments position on an issue submitted by the contractor or contract administrator. The first step of the disputes process when a contractor submits a claim that cannot be settled in an agreeable manner.

Debarred - To be prohibited, usually for a set amount of time, from bidding on government contracts or participating in any manner in a government contract (i.e. supplier or subcontractor).

Equitable adjustment - An appropriate modification of the amount due under a contract, or the time required for its performance, because of the issuance of a change order, which is just, fair and right in consideration of the facts and circumstance of the individual case.

Formal advertising - Sealed bidding with no restrictions on competition

Gratuities - Something of value that is given voluntarily without obligation. Gratuities are usually given to gain favor or influence.

Laborer - A non skilled employee that performs work at the jobsite. This work may not be of the type that a mechanic performs. Examples of laborer tasks include: cleanup, material handling, manual excavation. Work usually does not involve the use of tools requiring special skills or training.

Mechanic - A skilled employee that performs work at the jobsite. Wage determination will classify the different types of mechanic, i.e. pipe fitter, electrician, etc.. Supervisory, managerial, and sub-professional employees (surveyors, clerks, etc.) are not considered mechanics.

Mutual mistake - A mistake in which both parties to a contract share an erroneous belief concerning the basis for the contract. Example: A contract that is written and does not reflect the terms actually agreed to by the parties.

Responsible - A responsible contractor is one that has adequate financial resources, or the ability to secure such resources, is able to comply with the required or proposed delivery or performance schedule taking into account all existing business commitments, has a satisfactory record of performance, integrity, and business ethics; and is otherwise qualified and eligible to receive an award under applicable laws and regulations.

Responsive - A responsive contractor is one whose bid complies in all material respects with the invitation for bids. Such compliance enables bidders to stand on an equal footing and maintain the integrity of the contracting system.

Submittal - Literature that describes the technical aspects of the materials or products the contractor plans to use for the contract. Usually prepared by the manufacturer of the product.

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